Distr.
LIMITED
UNIDO/IS.432
10 January 1984
ENGLISH

UNITED NATIONS
INDUSTRIAL DEVELOPMENT ORGANIZATION

PROPOSALS FOR REFORM OF THE INTERNATIONAL FINANCIAL SYSTEM: IMPLICATIONS FOR INDUSTRIAL FINANCING

Sectoral Working Paper Series

No.14

Sectoral Studies Branch
Division for Industrial Studies

V.84-80293

SECTORAL WORKING PAPERS

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Preface

This document is one of several studies prepared by the Sectoral Studies Branch, Division for Industrial Studies, as a contribution to the preparation for the Fourth General Conference of UNIDO. They were used as input to the main background paper for Agenda item 5(c) of this Conference, "Mobilization of financial resources for industrial development", ID/CONF.5/13. Other titles include, "Types of finance for industry", UNIDO/IS.417, "Exchange of information among developing countries' banks to facilitate industrialization", UNIDO/IS.418 and "The role of South multilateral institutions in industrial finance", UNIDO/IS.419.

This review of recent proposals for reform of the international financial system aims both at presenting the basic features of these proposals and at analyzing their potential impact on industrial financing. Whereas all proposals, were they to be implemented, would have an effect on industrial financing, it is in most cases extremely difficult to specify how large the effect would be and what forms it would take, mainly because of the so called fungibility issue. In the present review an attempt at some tentative conclusions in this respect has been made. It is hoped that this will facilitate a discussion of various options to improve and increase industrial financing in developing countries.

The main results of this analysis have been incorporated in the above-mentioned main background paper for the agenda item on industrial financing of the Fourth General Conference.

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1. Effects of Various International Financing Reform Proposals on Industrialization in Developing Countries

ECONOMIC AND TECHNICAL ABBREVIATIONS

CFF	Conpensatory Finance Facility of IMF
GDP	Gross Domestic Product
ODA	Official Development Assistance
SALs	Structural Adjustment Loans
SDRs	Special Drawing Rights
$US	United States Dollar

ORGANIZATIONS

BIS	Bank for International Settlements
IDA	International Development Association
IDB	Inter-American Development Bank
IMF	International Monetary Fund
OECD	Organization for Economic Development and Co-operation
OPEC	Organization of Petroleum Exporting Countries
OPEC Fund	OPEC Fund for International Development
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization
UNDP	United Nations Development Programme

1. INTRODUCTION

There have been dramatic changes in the International Financial System over the past 10 to 15 years. The post-Bretton Woods era, characterized by an unprecedented high rate of sustained expansion of world output and trade came to an end in 1971. Fixed exchange rates gave way to floating rates. Successive and sizeable oil-price rises created new financial power and new financial problems. Inflation within the industrialized countries accelerated and became a dominant force in their economic decision-making process. It seemed possible that some of the relatively higher income developing countries might postpone or even avoid real crises by borrowing at low or negative real interest rates. However, towards the end of the 1970's, rising interest rates combined with international recession to rule out the borrow-and-export option, even for the relatively richer developing countries. In response to these changes - which have been particularly hard on low-income developing countries - there has been a succession of proposals for the reform of the international financial system. While some of these schemes are unlikely to receive any serious consideration, others have already been put into practice.

The aim of this paper is to provide a survey of the major proposals, with particular attention to their implications for industrial finance. Therefore, the proposals following have been grouped into the following areas:

(a) Proposals to improve finance in developing countries and/or investment programmes;

(b) Proposals to deal with debt problems;

(c) Proposals to enhance the liquidity of the international economy;

(d) Proposals to broaden compensatory finance;

(e) Proposals concerned with conditionality;

(f) Proposals concerned with low-income developing countries;

(g) Proposals for South-South co-operation;

Each of these areas is discussed in a separate part of Section (3) of this

paper. Each problem area is identified, major proposals briefly described and the consequences of the schemes are discussed, with special emphasis on their implications for industrial finance. In view of the overlap between some of the areas, certain proposals are considered briefly in more than one section.

Certain general aspects of the implications common to all proposals, are discussed in Section (2) of this paper. The overriding influence on the well-being and prospects of industrialization is the state of the world economy. A sustained expansion of world output is the most important factor in the promotion of industrial development. Therefore, Section (4) is devoted to this issue while in Section (5) general conclusions are discussed.

2. GENERAL CONSIDERATIONS

In considering the impact of proposed reforms in the international financial system on industrial finance, various general considerations which are relevant to most changes need to be borne in mind.

(a) Any change which permits a faster expansion in output among industrialized countries will also tend to lead to faster growth in output in the South. Demand for both primary products and manufactures from the South would rise. The income elasticity of demand for manufactures is higher than that for primary products. Therefore, demand for products of the industrial sector is likely to rise faster than demand for primary products. The industrial sector of developing countries will also benefit indirectly from extra output and incomes in the primary product sector. This would raise savings and foreign exchange and thereby contribute to industrial finance. While higher growth among industrialized countries would probably involve higher rates of investment, it would also generate additional

incomes and higher levels of savings in developing countries. Higher growth among developed countries is likely to be associated with improved export earnings among developing countries. This would consequently improve their debt service ratios and increase the capacity of developing countries to borrow on commercial markets. Higher growth among developed countries will, therefore, support industrial expansion among developing countries in a variety of ways. Hence the effects of proposed changes in output in developed countries is of major importance to this analysis.

(b) Any change which permits a higher growth in output among developing countries will improve the prospects for their industrial sectors irrespective of whether the original impetus comes from within or outside the industrial sector. Change may be caused by higher growth rates in developed countries, or results from other sources such as increased savings and investment in developing countries, or greater trade among them. This is because of the high income elasticity of demand for industrial products within developing countries, which, combined with the development strategy adopted by most of them, means that a substantial proportion of additional income is spent on industrial products. Furthermore, a substantial proportion of extra investment goes to the industrial sector. The green revolution provided an example. The new seeds raised output in the agriculture sector in the first place. There were also immediate secondary effects in terms of extra demand for inputs and consumer goods provided by the industrial sector. Therefore, the industrial sector also benefited.

(c) Much finance is fungible. Finance may be explicitly directed to one sector, but because of this fungibility its net effect may be on another sector. For example, the World Bank may redirect its loans away from industry to agriculture. However, this may have a smaller than anticipated

effect on the actual availability of finance for either sector if the government and private banks redirect their finance in the opposite direction. Moreover, finance of projects in one sector releases funds for other uses and hence indirectly increases the supply of funds to other sectors. The precise sectoral composition of new finance may, therefore, not be an indication of the actual net effects.

(d) New schemes involving new sources of finance may not provide additional finance, but be substitutes for existing funds. For example, a new South Bank raising large amounts on world markets may reduce the flows to developing countries going directly via the commercial sector to individual projects in individual countries. It may also reduce the borrowing and lending of other international institutions. Hence the net effects of the new schemes will depend on the extent of additionality, where the finance partly displaces existing flows. The financial implications will depend on the relative effects of the new source of finance as compared with the finance it displaces as well as the extent of fungibility.

(e) The sectoral distribution of additional finance is likely to depend, in part, on the country distribution of the finance. Middle-income countries, for example, have on average a higher proportion of manufacturing in Gross Domestic Product (GDP) than low income countries. A higher proportion of their exports is accounted for by manufactured products. And manufacturing in middle-income developing countries has shown a much higher rate of growth than among low-income countries over the past 20 years. It is likely that additional finance will be more industrially oriented among middle-income than low-income countries. It follows, therefore, that the effects of any particular scheme on industrial finance will depend partly on the country distribution of the flows. Schemes that involve a greater proportion of finance

going to middle-income countries will have a larger proportion of industrial finance.

(f) The availability of industrial finance is only one of the necessary conditions for industrialization. It is also necessary to identify and develop appropriate projects, to obtain the required managerial and technical resources and to secure markets for the output. In some countries, the conditions for successful industrial projects are not present. New mechanisms which contribute to the realization of such conditions may be more effective in attracting industrial finance, than mechanisms exclusively concerned with the provision of industrial finance.

3. TYPES OF SCHEMES

3.1. Proposals to improve the finance of developing countries' deficits and/or investment programmes.

It is well known that the current account deficits of oil-importing developing countries increased dramatically during the 1970's. The World Bank's 1981 World Development Report[1/] estimated that the aggregate current account deficit of these countries grew, in real terms, at an annual average of over 12 per cent. In some years, this was accompanied by an important shift in the countries which had large current account surpluses. Indeed, after 1973, oil-exporting developing countries at times replaced the developed countries as the major net suppliers of capital to deficit developing countries.

Soon after this shift took place, many proposals began to appear calling for the creation of new mechanisms or institutions (particularly official ones) to channel or "recycle" the large volume of funds from surplus to deficit

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1/ World Development Report, 1981, (World Bank, Washington D.C.), Table 5-3.

countries. These proposals had very limited impact during the mid-1970's. There were, however , some mechanisms created, such as the International Monetary Fund's (IMF) Oil Facility, but their effects were limited. The bulk of the "recycling" - as well as of other important financing transactions affecting developing countries - was de facto carried out by the private multinational banking system of the developed countries. This large change in the form of financing the current account deficits of developing countries significantly affected their growth and development, with many negative consequences.2/

Towards the end of the 1970's, the heavy reliance of developing countries on private bank lending came under considerable debate and criticism. Increasing doubts were expressed about the banks' willingness or ability to continue financing developing countries' deficits in the 1980's to the same extent as they had in the previous decade. Such doubts were shared by an increasing number of bankers and confirmed by later developments. In fact, from 1979 on, the share of net private long-term capital flows in the financing of developing countries' current account deficits declined significantly. According to the 1982 World Economic Outlook of the IMF this share fell from its peak of 38.2 per cent in 1978 to 31.6 per cent in 1979.

In addition, there were increasing fears that excessive reliance on private sources might lead to instability in the world financial system.

2/ For a more detailed discussion of the question, see S. Griffith-Jones, "The growth of multinational banking, the euro-currency market, and their effects on developing countries", Journal of Development Studies, Vol.16 No.2, January 1980, pp.204-223; A. Sengupta and F. Stewart, International Financial Co-operation: A Framework, (Frances Pinter, London 1982) especially Chapter 2.

Simultaneously, it was generally perceived that a large proportion of the funds being channelled by institutions dominated by developed countries' originated in the oil-surplus developing countries. This perception and the foregoing factors formed the basis for a number of proposals for new ways of channelling funds to deficit developing countries.

Before examining these proposals in some detail, it seems necessary to look at them from a current perspective.

(a) A first obvious, but still noteworthy, point is that none of the proposals for creating new institutions have yet been implemented. However, some, such as the proposal for an energy affiliate of the World Bank, have received backing from several industrial countries. Some of these proposals date as far back as 1977 implying that new institutions are at the very least extremely difficult to establish.

(b) The need for alternative institutions and/or mechanisms seems to have grown; particularly since late 1982. The private international banks underwent a period (late 1982 to early 1983) when very serious and widespread doubts were being expressed about their stability. Although the situation seems to have temporarily eased somewhat, most problems have been postponed rather than tackled fundamentally. Thus, the risks for the world's banking system remain very high. This is illustrated by the fact that the collective debt of the 25 countries which, in February 1983, were in arrears, in the process of rescheduling, or had already rescheduled portions of their debt, amounted to more than $US. 200 billion. This constitutes nearly half of the total debt which developing and East European countries owe to commercial banks.3/

3/ World Financial Markets, (Morgan Guaranty Trust Company, New York) February 1983.

Increasingly, therefore, it is not just developing countries' governments or academics who are calling for new institutions or schemes to deal with the problems of handling developing countries' existing debt and new financing needs. Private bankers are also presenting their own proposals for new institutions or mechanisms, which would largely rely on official initiatives. These are, however, naturally more concerned with helping to overcome the banks' critical situation rather than with alleviating the developing countries' foreign exchange constraints.

(c) The need for alternative channels for developing countries' finance became objectively more critical. As support for new institutions spread to other circles, particularly to some banking ones, the likelihood of new institution-building were further diminished by two elements. Firstly, current account surpluses of oil exporting developing countries had shrunk dramatically since 1982. Even though some capital-surplus countries retain large holdings of foreign exchange assets, nearly all sources for funding developing countries' deficits have reverted to developed countries. Secondly, the governments of the main industrial countries are currently characterized by both financial and institutional conservatism. Therefore, the likelihood of the establishment of new institutions - whose capital would have to be financed to a greater proportion than in the mid-or late-1970's by developed countries - seems much lower. As a result, much recent debate has focused on proposals to enlarge existing institutions; particularly the IMF and the World Bank. It is also being considered to make their lending more appropriate to the needs of developing countries.

This "new institution pessimism" refers mainly to the short term. Oil exporters (and/or other categories of developing countries) may again have surpluses. Governments in developed countries may change their ideological preference towards less conservatism in both financial and

institutional matters. They may even be forced to do so by financial crisis in their banking systems, or social and political unrest in developing countries following "adjustment via acute recession" forced upon them by foreign exchange constraints.

Many recent proposals combine suggestions for more appropriate modes of financing current deficits with proposals for changing the structure of already accumulated debt. The latter impinges heavily on future financial needs. For analytical purposes the detailed discussion of financing current and future needs (surveyed here) has been separated from the discussion on debt restructuring (see below). However, the links between both types of proposals shall be stressed.

Proposals to improve the process of financing developing countries' deficits can be broadly put in the following categories:

(a) Those mainly directed at helping to sustain private flows, and making them more appropriate to developing countries' needs;

(b) Those mainly directed at increasing the role of existing public institutions;

(c) Those directed at creation of new public international financial institutions.

3.1.1. Proposals to help sustain private flows and create mechanisms more appropriate for developing countries

There is a large number of proposals which can be grouped into this category. With the increasing financial distress since late 1982 even bankers, themselves, began to make such proposals.

One of the first of such proposals was made by Mexico.[4/] It proposed to establish a fund to be financed by the issue of 15-year bonds on the international capital markets. These bonds were to be guaranteed by the governments of developed as well as some developing countries. The funds would be used to grant long-term loans with maturities of about 15 years. They were to be used only for the purchase of capital goods from other developing countries or from developed countries whose governments had contributed to the bond issue.

A more recent proposal, given high priority by the United Nations Conference on Trade and Development (UNCTAD)[5/] and strongly supported by the Group of 77[6/] called for the establishment of an International Export Credit Guarantee Facility. This facility would guarantee export credits of developing countries, mainly for capital goods, so as to improve the marketability of export credit papers. It would not engage in direct lending, but by providing a strong guarantee the facility would help developing countries rediscount their paper on favourable terms in international capital markets. The facility would be backed by multilateral financial institutions such as the World Bank and industrialized countries and counter-guaranteed by national agencies in the exporting developing countries.

A broader proposal for an international loan insurance fund was put forward by Zolotas.[7/] The guarantors would be the IMF, the World Bank and

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4/ Put forward by the Government of Mexico at the meeting of the Development Committee in Mexico City, April 1978.

5/ See UNCTAD Report of the Inter-Governmental Group of Experts on an Export Credit Guarantee Facility (TD/B/889) and UNCTAD VI International Financial and Monetary Issues Policy Paper (TD-278), Belgrade, June 1983.

6/ The Buenos Aires Platform, final document of the Fifth Ministerial Meeting of the Group of 77, 28 March-9 April 1983.

7/ X. Zolotas, "The case for an international loan insurance fund", The Banker, Vol.130 No.657, November 1980, pp. 33-36.

Governments of both developed nations and member countries of the Organization of Petroleum Exporting Countries (OPEC). Each guarantor would be assigned a quota in order to determine the limits for capital calls on the guarantors. Guarantees for loans were to be extended both for balance of payments support and for developing projects. They would cover a percentage of loans, varying for different countries according to their access to capital markets.

More recently, there have been several proposals to sustain private flows to developing countries. These are intended to allow access by those countries perceived as less "creditworthy" by the markets. They would also provide longer-term, fixed interest finance for developing countries.

Mackworth-Young[8/] has propounded that all new borrowing - and possibly debts already contracted - by developing countries should take the form of bonds, guaranteed by some supra-national agency, backed up by the world's main central banks.

John Williamson[9/] has also suggested that long-term indexed bonds be issued by an agency such as the IMF or the World Bank acting as the agent for a group of developing countries. Partial guarantees to be provided by the stock of the IMF gold or other assets. One interesting aspect of his proposal is that it attempts to define more precisely the source for such

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8/ W. Mackworth-Young, "Role for International bond markets", World Banking Supplement, The Financial Times, 9 May 1983.

9/ John Williamson, "The why and how of funding LDC debt", Development Finance: Framework for International Co-operation, S. Al-Shaikly (ed.), (Frances Pinter, London, 1982). More recently, this proposal was presented in his paper "International monetary reform: An Agenda for the 1980's", Background paper for the Study on the International Financial and Trading System (Commonwealth Secretariat, March 1983).

long-term funding. This includes tapping the portfolios of pension funds and insurance companies in developed countries. These are institutions that have long-dated liabilities and are more interested in real yields than in being assured of a given nominal book value at each moment of time. Williamson points out that in the past low-absorbing OPEC governments would have also been natural sources for such bonds. Indeed, his initial proposal was largely geared towards this source.

Official institutions, such as the World Bank and some of the regional development banks, have even been discussing the expanded use of guarantees to provide political risk insurance. Frank[10/] has recently suggested that public and private political risk insurance programmes might be combined (where public insurance would cover the larger maturities). Some private insurance companies have recently developed new political risk insurance programmes to support loan and equity investments in developing countries. One example is a programme developed to finance short and medium-term export receivables. The notes based on these receivables have got high ratings in US private and public securities markets.

Finally, there are more general proposals aiming at averting the damaging effects of a major financial crisis on private lending to developing countries. And particularly to help sustain private lending loans in times of widespread fear of defaults and financial crisis, which is usually accompanied by an increasing amount of reschedulings and arrears. Recently Lipton and Griffith-Jones[11/] have suggested the need for an explicit international lender of last

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10/ C.R. Frank, "Future financing of the capital needs of developing countries", Background Paper for the Study on the International Financial and Trading System, (Commonwealth Secretariat, March 1983).

11/ M. Lipton and S. Griffith-Jones, "International lenders of last resort: Are changes required?", Background Paper for the Study on International Financial and Trading System, (Commonwealth Secretariat, May 1983).

resort. This is to be backed by the central banks of the developed countries, and be subjected to far stricter supervision than commercial banks are by these central banks. Such a combination should stabilize the growth of private lending in "euphoria" stages and minimize its contraction during critical times. This particular proposal would accept, as "collateral" for using the international lender of last resort facility, the bad debts which the banks have in their portfolio, but at a large discount. Afterwards the proposed international lender of last resort would negotiate with developing countries' borrowers the repayment of the debt at lengthened maturities and possibly lower interest rates. This proposal, therefore, has close links with those discussed below in Section 4.1.3., for dealing with the "debt overhang". Its main target, however, is to sustain and possibly increase present as well as future credit flows to developing countries. This issue is further discussed in connection with stability and growth in the world economy (Section 4).

There have been somewhat similar proposals which, however, give the leading role for last resort guarantees to private banks themselves rather than central banks. One example is the proposal of a safety net for the international banking system, put forth by Guth. This would involve the commercial banks establishing a fund which could be drawn on in the event of difficulties.

3.1.2. Proposals to increase the role of existing public institutions

These proposals focus particularly on further increasing the role of the IMF, the World Bank and regional development banks. Some of these proposals stress more funding for the larger role of such public institutions by an expansion of their capital base. This would imply a greater budgetary contribution from industrial countries' governments. Other proposals rely more on financing this enlarged lending capacity by new or greater borrowing

on the private capital markets. The main proposals in this category are the following:-

IMF

It is well known that the UNCTAD Secretariat[12/] as well as the Group of 77 have argued that the IMF Eighth Quota Review (which agreed to increase quotas by 47.5 per cent) should have implied a doubling of the IMF quotas. The Group of 77 was, therefore, dissatisfied with the limited increase agreed, and has suggested that the IMF Ninth Quota Review be significantly advanced, (to before the end of 1984) and that it should involve a very large increase in quotas.

It has been suggested that the IMF should borrow on the private capital markets, due to the inadequacy of its present resources. Although the IMF has never borrowed from the markets, its Articles of Agreement give it authority to borrow from any source and in the currency of any memer country. The only conditions being that it obtains the consent of the government of the member country in whose currency it proposes to borrow.

The IMF has publicly discussed this option. Recently, the prestigious Group of 30 published a report[13/] stressing the need for the IMF to borrow very soon from the private financial markets, and "not to wait until it faces a dire shortage of funds". The report concludes that the IMF - if it needed to raise substantial amounts - should do so on the syndicated loan market or through large standby lines of credit with banks in major centres. In case

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12/ See UNCTAD VI International Financial and Monetary Issues Policy Paper, (TD-278), Belgrade, June 1983.

13/ Group of 30, The International Monetary Fund and the Private Capital Markets, New York, 1983.

the IMF needed to have regular resource to the markets, it would be appropriate for the IMF to consider eventually tapping every significant capital market open to it.

There are a number of other proposals which relate not so much to the size of the IMF but to individual facilities which it provides. The Group of 77 and the UNCTAD Secretariat continue to advocate the establishment of a new low-conditional facility to extend medium-term payments financing to developing countries. This facility would be financed from new Special Drawing Right (SDR) allocations. (See proposals below). They also advocate the establishment of a new Trust Fund, financed from additional sales of the IMF gold stock. The proceeds of this sale would allow the IMF to lend to the poorest countries on the same terms and maturity as the previous Trust Fund (i.e. for a maturity of 10 years, with a five-year period of grace and an interest rate of 0.5 per cent).

The need to revise the conditionality attached to IMF lending has been widely expressed especially by the UNCTAD Secretariat and the Group of 77. This is discussed further in Section 3.5.

World Bank[14/]

There are several proposals to advance the lending programme of the World Bank. Developing countries urge that the regular lending programme of the World Bank - presently expected to amount to $US 60 billion for the five-year period ending in 1986 - should be accelerated so as to be fully disbursed over four years. To sustain such increased lending, it is

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14/ Some of the proposals which involve the World Bank (e.g. the Mexican proposals) are discussed in other sections.

suggested by both the UNCTAD Secretariat and the Group of 77 that the subscribed capital base be increased (without necessarily requiring any or, at least, not a large paid-in capital) and/or that the "gearing ratio" be increased.

The World Bank, itself, has recently stressed the possibility of expanding its co-financing activities with commercial banks. New initiatives were started in January 1983 on an experimental basis.15/ In addition to making a direct loan for a project, the World Bank plans to participate in finding commercial finance. The following three new approaches for co-financing have been experimentally approved:

(a) Direct financial participation by the World Bank in the later maturities of a commercial loan. Initially repayments would be made to commercial lenders, until their share of the loan is fully paid up. In later years, principal payments would be applied to the World Bank's share;

(b) Contingent participation by the World Bank in the later maturities of a commercial loan, which would, initially, be entirely financed by commercial lenders. Annual debt service would be fixed, even though the interest rate would be variable. In case the interest rate rises above the initial rate, the amortization period would be lengthened. The World Bank would then make a contingent commitment to cover the longer repayment period. The further benefit of this approach, in addition to extended maturities, is that it provides borrowers with a fixed payment schedule for their debt service, permitting better planning.

(c) Guarantees of the later maturities of a private loan by the World Bank, instead of direct funding.

15/ World Bank News Release on "World Bank Resources Co-financing Instruments", 13 January 1983.

Regional banks

The proposals are somewhat similar to those made for the World Bank: enlargement of their capital base and possible increase of their gearing ratios. Furthermore it has been suggested by the UNCTAD Secretariat and others that their borrowing on private capital markets (as proportion of capital and reserves) could be significantly increased.

3.1.3. Proposals to create new public international financial institutions

Support for the creation of new institutions is currently at a low ebb, because of the reasons discussed above. In view of the fact that most proposals are already quite well known, and have been reviewed elsewhere,[16/] only the main ones will be examined briefly here. Those proposals linked more directly to industrial finance will be discussed first.

The International Bank for Industrial Development, proposed by the United Nations Industrial Development Organization (UNIDO) Secretariat in 1981.[17/] This proposal was based on the assumption that there are important quantitative and qualitative gaps in the present international financial system. It was considered that these gaps constrain the deployment of financial surpluses for investment in new industrial capacity in developing countries.

16/ See A. Sengupta and F. Stewart, International Financial Co-operation: A Framework (Frances Pinter, London, 1982); and UNIDO Secretariat, First Consultation on Industrial Financing, Spain, 18-22 October 1982, Issue No.3: "Can the possible industrial financing gap be overcome by the elaboration of innovative concepts leading to the acceptance of new mechanisms and/or institutions", ID/WG.377/1.

17/ For more details, see UNIDO "Proposal for setting up an International Bank for Industrial Development", submitted by the UNIDO Executive Director at the Industrial Development Board, Vienna, 15-19 May 1981, ID/B/261 and Add.7.

The proposed International Bank for Industrial Development would act as a financial intermediary in the market place, for channelling funds to industrial investment in developing countries. It would primarily make project loans and in some circumstances programme loans. The capital base would consist of subscription by member governments, only a small proportion of which would be called up. Governments of developing countries would have a greater share in the decision-making process of this institution than in most existing multilateral agencies.

Major features of the institution's operations would be:

(a) Maturity transformation of the funds borrowed on the markets, to make lending appropriate for industrial projects;

(b) Interest subsidization at differential rates, funded through a scheme linked to export orders;

(c) Offering re-financing facilities for export credit;

(d) Providing a package of services such as project generation and promotion of joint ventures, as well as finance.

The Multinational Trust Fund for Industrial Development proposed by the Inter-American Development Bank (IDB) in 1979, to be based on contributions from member governments and borrowing in financial and capital markets. The aim was to provide support for small and medium-scale industrial enterprises in IDB's Latin American and Caribbean member countries. The fund would be administered by the IDB but its resources and account would be kept independently.

There are other initiatives, which focus on financing particular sectors. An example of these is the energy affiliate for the World Bank proposed in 1980.

Finally, proposals have been made for new global institutions, which would finance general development programmes and/or projects in developing countries. Amongst the most important proposals were the World Development Fund, proposed by the Brandt Commission Report in 1980 (proposal repeated in 1983)[18/] and the proposal for a South Development Agency presented by Algeria and Venezuela to the OPEC ministerial meeting, held in December 1979.

The World Development Fund was conceived as an institution mainly providing long-term programme finance to bridge the gap between long-term financing and short-term adjustment finance. The former was available from the World Bank and the latter from the IMF. It was thought that it should have universal membership with decision-making shared more equally than in existing institutions between developed and developing countries. It was envisaged that the institution would obtain the great bulk of its resources from government contributions. They were to be based on increases in aid and/or universal and automatic levies, i.e. international taxation. Thus, amongst other conditions, for such a World Development Fund to be created and operated on a large scale the willingness of industrial (and to a lesser extent OPEC) countries' governments would be required to provide official development assistance on a much larger scale than at present. Given that the levels of Official Development Assistance (ODA) have, in fact, been declining (in 1981 they even fell in nominal terms) it seems very unlikely that such a proposal will be implemented on this basis.

The proposal for a South Development Agency was based on the belief that it would strengthen solidarity of OPEC countries and other developing countries by pooling their credit capacities for the benefit of all developing countries. The proposal was based on an expansion of the OPEC Fund for international development on contributions from OPEC governments for its

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18/ See Brandt Commission, "Common Crisis North-South: Co-operation for World Recovery", 1983.

this capital, it was envisaged that bonds would be issued in international capital markets. It was believed that, initially, an important part of the bond issues would be taken up by OPEC countries themselves. Such an institution was perceived to have been more genuinely concerned with the South's development, as only developing countries could participate in it. The institution's feasibility was based on the existence of large OPEC current account surpluses and the willingness to invest them in such an institution. Currently, OPEC surpluses have - at least in the short-term - disappeared, making such a proposal not feasible. Furthermore, even if such surpluses were to reappear, it is not entirely clear whether the capital-surplus oil exporting governments still favour investing their funds in such an institution. They may prefer investments in institutions with developed countries' participation (like the IMF or the World Bank) which may be perceived by them as safer vehicles for their capitals. A more recent proposal for a South Bank will be discussed below in Section (3.7.).

3.1.4. Potential implications (with particular reference to industrial finance) of proposals to improve the finance of developing countries' deficits and/or investment programmes

In analysing the impact of such proposals there are four key issues:

(a) Whether they would generate additional flows to developing countries;

(b) Whether they would affect the sectoral composition of financial flows to a country;

(c) How they would affect the distribution of finance among developing countries;

(d) The terms and conditions of the financial flows.

(a) Additionality

The proposals concerned with sustaining and improving flows of finance of the private sector generally involve some official guarantee (partial or total) for private flows.

It has often been argued that the funds used to provide any guarantee facility could be alternatively used for lending directly to developing countries by governments or international public institutions. However, a guarantee facility could offer a higher gearing ratio than the World Bank or the regional development banks, so that the finance diverted to such a guarantee fund would increase total lending. This would only occur if the facility were not administered by these bodies - as at present their charters reduce their capacity to lend directly by the same amount as the guarantee - or if the charters of such institutions were modified to treat guarantees more flexibly.

The additional financial flows resulting from guarantees could be particularly important in times such as now when there is relatively widespread financial distress and fears that such distress may be transformed into a major financial crisis. The creation of guarantees, seen as reliable by the private sector, could help restore confidence and generate significantly larger private flows than the size of the actual guarantees. The significance and volume of such guarantees could decline, when and if, confidence in the private markets is restored and there is improvement in the developing countries' ability to repay.

Finally, the broader proposals for guaranteeing all commercial lending to developing countries by international lender of last resort facilities could be very significant for the maintenance of confidence, and sustaining private

flows to developing countries in critical times. It could be combined with the introduction of more appropriate financial mechanisms, stronger supervision and more desirable distribution among developing countries. Although highly desirable, the establishment of some sort of supra-national lender of last resort may be some way off. It is seen by some observers as taking sovereignty from participating central banks. It also raises the difficult questions of how banks from non-participating countries would be treated - particularly of those off-shore centres which have no national lender of last resort capacity. A particularly serious problem is the potentially high cost of such a facility, to which central banks are currently unwilling a priori to commit themselves, preferring a case-by-case approach, in which they have greater control.

The other set of proposals is concerned with increasing the lending of existing public institutions, or creating new institutions for channelling funds to developing countries. To decide whether and by now much funds channelled in this way would be additional is a complex and difficult matter. It depends on what else is happening in the world economy and to international institutions, as well as the nature of the institutions themselves. At the moment, when commercial lending is low because of lack of confidence, it seems likely that extra public sector borrowing and lending could considerably increase international lending to developing countries. This would happen without cutting into private sector lending which is constrained for reasons other than availability of finance. Indeed substantial extra public lending might actually increase the flows of private finance by enhancing the banks' confidence. But public lending, on hard terms, adds to developing countries' total indebtedness, while there may be some upper limit on the willingness of

banks and others to be financially involved in developing countries. Therefore, in normal times it can be expected that a greater role for public institutions will involve a smaller role for private ones. Moreover, there may also be a certain sharing out within the public sector. A new World Development Fund, for example, could be expected to reduce the prospects for expansion of the World Bank. It would, therefore, be unrealistic to assume a 100 per cent 'additionality' from any new institution in the medium term. But because of the great shortage - at the momemt - of institutions willing and able to lend to developing countries on a scale commensurate with their needs, it seems likely that much extra finance would be additional. The possibility of reduced additionality should not be used as an argument against new lending at the present time.

(b) Sectoral composition

Different financial mechanisms are associated with different sectoral compositions of finance. For example, the private sector tends to lend more to industry, while the multilateral institutions have a greater agricultural/infrastructural element in their lending. However, some forms of lending (e.g. the IMF Balance-of-Payments support) have no specific sectoral composition. Owing to the fungibility of finance, the actual or nominal sectoral composition of financial flows is not necessarily a guide to the effects on availability of finance to different sectors. By lending to one sector, funds may be released which go to other sectors. However, it is very unlikely that fungibility is ever total.

The proposals to sustain commercial lending are likely to have a significant industrial sector component. This is especially true of the schemes intended to finance industrial exports (i.e. the Mexican schemes for finance of capital goods and the export credit guarantee schemes). IMF finance is general and not sectoral. However, the release of foreign exchange will, indirectly,

improve the financial position of the industrial sector in recipient countries. Among the proposed new institutions, the International Bank for Industrial Development would be totally devoted to industrial finance, as would the proposed Multinational Trust Fund for Industrial Development. The sectoral composition of the proposed new global institutions would depend on the details of their operation. For the most part, it seems that they are intended to provide general medium-term balance-of-payments support - providing indirect, rather than direct, assistance to the industrial sector.

(c) Country distribution

The country composition of financial flows affects the sectoral compositions. The industrial sector tends to be more significant in middle-income than low-income countries, and in resource-poor, rather than resource-rich countries. But at the margin all developing countries are increasing the proportion of output accounted for by the industrial sector, so that the country composition of flows may not make a great deal of difference to the sectoral composition.

In the past, the commercial sector financial flows have been heavily concentrated among a small number of middle-income countries. It might have been expected that the creation of guarantee facilities would broaden the distribution of commercial flows between developing countries. This seemed of particular importance in the late 1970's when it was realized that such a high proportion of commercial lending went to certain upper middle-income developing countries. Thus a guarantee mechanism was perceived as helping channel a relatively higher proportion of funds towards lower-income countries, considered as less "creditworthy" by private banks. This point is still valid, but to a somewhat lesser extent. As a result of the major and increasing rescheduling problems arising with the debts of the largest borrowers, - and

particularly the Latin American ones, - which include many of the more industrialized developing countries, private bankers have begun to diversify their portfolio. This has been done by lending proportionately more to countries to which they had given less credit in the past. This includes some of the relatively poorer countries although clearly to a limited extent. This trend is reflected in the fact that the terms (of maturities and spreads) on which private bankers are lending to lower-income countries are currently improving rapidly. The terms are, in fact, significantly more favourable than those offered to upper middle-income developing countries.19/ Therefore it is not as clear as it seemed in the past that the creation of guarantee mechanisms would in fact lead to a greater spreading of loans among developing countries. In fact, guarantees might even turn the banks more towards lending to their old clients: the middle-income and relatively more industrialized countries. Under current circumstances, the introduction of guarantee schemes would channel funds more to countries which banks define as "illiquid" in the short term but "solvent" in the long term. Several of the newly industrialized countries would fall in this category. Therefore, such guarantees could probably contribute towards resumed growth of private lending to them, helping these countries to resume their previous rapid industrialization. The extent to which guarantee mechanisms would channel more finance to the poorer countries is less clear. Although preferences for such countries seems to have increased somewhat recently bankers may regard them as both "illiquid" and "insolvent".

Schemes involving official institutions are likely to be proportionately more geared towards low-income countries. For example, in 1980 while low-income

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19/ Euromoney, May 1983, "Euromoney Index", p. 254.

countries received only 2.5 per cent of commercial loans to all developing countries, they received over 40 per cent of ODA. Low-income countries also receive a higher proportion of non-concessional loans from official agencies than their share of commercial sector finance.

As far as the IMF is concerned, the country composition depends on the precise facilities available in relation to country needs and requests. Expansion of facilities providing general balance-of-payments support for countries in substantial financial difficulties is likely to provide most finance to the now crisis-ridden middle-income countries. They borrowed heavily in the 1970's, and their balance-of-payment deficits are of a massive dimension. Expansion of facilities to support those suffering most from commodity price fluctuations, on the other hand, (see discussion below) would, to a greater extent, involve funds for low-income countries.

The country composition of lending of the proposed new institutions will also depend on the nature of these institutions. But a more even and regular distribution can be expected than provided by the commercial sector - probably not dissimilar to the flows from the World Bank.

(d) Terms and conditions

Several of the proposals related to commercial flows aim to increase the length of maturities, and some involve fixed interest finance. These changes would make lending more appropriate to development needs, and particularly appropriate for investment with long gestation periods such as investment in new industrial sectors, infrastructure, etc. Such a trend would be favourable to all economic sectors, but could be particularly valuable

to the industrial sector where a longer-time horizon for the finance available could allow more long-term planning and investment with a longer gestation period.

As far as public agencies are concerned, we need to distinguish between the IMF and other institutions. The IMF currently provides short-term finance, much of which is subject to stringent conditions. There have been a number of proposals for relaxing and changing this conditionality, which is discussed in detail below (Section 3.5.).

The World Bank has recently been increasing the proportion of non-project finance it provides, in the form of structural adjustment loans (SAL). There is a critical need for untied financial support at the present time because of the acute foreign exchange shortages. These are preventing utilization of existing projects and make it wasteful to spend money on new projects, rather than permitting full use of existing ones. However, the SALs are accompanied by some quite strict conditions, not dissimilar to those of the IMF (see discussion below), and often require prior agreement by the country with the IMF. One frequent requirement is for import liberalization, which, in the short run, can have devastating effects on a country's industrial sector.

For the other public institutions, the general intention is similar to the proposals for the commercial sector. This is to extend the length of maturity of loans, and stabilize and improve the terms. These would assist in the long-term planning of all sectors of the economies of developing countries, and improve the terms on which they receive finance. The proposed International Bank for Industrial Development would have the greatest direct impact on industrial finance, but the other schemes (e.g. World Development Fund) would indirectly improve the terms on which industry acquires finance.

Schemes which use existing institutions to expand financial flows to developing countries have the advantage that they tend to be technically easier to implement. It would be easier for some existing institutions to raise money on the private capital markets than for an entirely new institution to do so. They are also more likely to be backed by governments of developed countries. The disadvantage is that it is more likely that such enhanced flows would be granted according to criteria that have evolved in past practice, and may, therefore, in many cases be more appropriate for the conditions of the past than those of the present or the future.

3.2. Proposals to deal with debt problems

One of the crucial issues which influences the size and the financing of present and future current account deficits of developing countries is the impact of the already accumulated "debt overhang".

The impact of past debt on current deficits is clearly illustrated by figures published by the Bank for International Settlements (BIS).[20/] With great difficulty and high internal costs non-OPEC developing countries were able to reduce the non-interest content of their current account deficit from $US 38 billion in 1980 to $US 15.5 billion in 1982. However, $US 19.5 billion of this $US 22.5 adjustment was offset by a further increase in their net interest payments. This trend is far more spectacular in relation to the three largest borrowers - Brazil, Mexico and Argentina. They accounted for 52 per cent of total debt owed by non-OPEC developing countries to private banks. Between 1980 and 1982, the combined current account external deficits of these three countries remained virtually unchanged at around $US 24 billion. However, excluding net interest payments (which had increased by approximately

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20/ BIS, 53rd Annual Reports, (Basle, Switzerland, June 1983), p.124.

$US 13.5 billion during those two years), the balance of their current account transactions had shifted from a $US 12 billion deficit to a $US 1.5 billion surplus.

There is a wide variety of proposals to deal with the problems of debt overhang and debt rescheduling. They range from procedural proposals to improve the process of debt renegotiation to much more radical suggestions of debt consolidation or rediscounting.

UNCTAD resolutions in 1978 and 1980 proposed that developing countries submit their own plans for resolving official debt problems, in a forum of their own choosing. The IMF and the World Bank were to offer analysis and advice only, and countries should initiate actions at an early stage when faced with debt difficulties. A recent UNCTAD Secretariat document,[21/] however, concedes that these resolutions do not seem to have led to significantly different agreements sealed within the Paris Club renegotiations of official debt.[22/]

The UNCTAD document stresses other aspects, such as the need to provide bridge finance to deal with immediate problems. It also calls for a longer period of preparation for Paris Club meetings with a view to seeking medium-term solutions. Furthermore, it suggests multi-year framework agreements with several consolidation agreements (this proposal has also begun to be made by private bankers).

21/ UNCTAD VI, International Financial and Monetary Issues Policy Paper, (TD-278), Belgrade, June 1983.

22/ Group of Ten established in 1962 as an informal group of those countries which contribute to the "General Agreements to Borrow" (GAB) sometimes referred to as the Paris Club. The arrangements were established in 1962 by a decision of the Executive Board of the IMF, with the purpose of increasing the potential lending resources of the IMF.

UNCTAD has also raised the possibility of generalized debt measures. For example, it suggests as an alternative the postponement, on an exceptional basis, of debt payments due to official and officially guaranteed loans from developed countries. The implication of this proposal for ODA loans is that amortization payments scheduled during a two-year period could be added at the end of the scheduled repayment period so that all original maturities would be extended by two years. Proposals have also been made by UNCTAD to consolidate a large proportion of official and officially guaranteed export credits.

Undoubtedly these proposals would be particularly beneficial to poorer countries, which rely much more heavily than other developing countries on official debt. However, it seems unlikely that generalized proposals for debt rescheduling will be acceptable to the governments of developed countries, who are the main creditors.

It is interesting to note that in the case of private debt, several bankers have themselves suggested the possibility of rediscounting and/or consolidating debts of developing countries with private banks. Bankers like Felix Rohatyn, Richard Weinert, William Mackworth-Young and others[23/] have presented somewhat similar proposals which would lengthen the maturity of and reduce the rate of interest on developing country bank debts. Such proposals are based on the recognition that large volumes of relatively short-term floating-rate debt are very inappropriate for the funding of developing countries' needs. And unless already existing debts are transformed into more appropriate instruments, debt crises will become a relatively permanent feature of the international economy.

23/ F. Rohatyn, "New Bretton Woods conference needed"; and W. Mackworth-Young, "Role for international bond markets", both in World Banking Supplement, The Financial Times, 9 May 1983. Such proposals are reviewed in the 1983 Brandt Commission Report.

One such proposal implies that an existing international agency (or a new one) would purchase developing countries' obligations to banks but at a discount. The debts would then be renegotiated, and having been taken over at a discount, their maturities could be stretched out and interest rates reduced without budgetary cost to the developed countries. The debt burden of developing countries would, therefore, be somewhat alleviated and they would be less constrained in their growth and development programmes. The banks would be paying a cost, but gain the advantage of an alternative mid-way option of keeping loans on their books, or writing them off completely (which are the main options open at present).

However, it has been pointed out that such a scheme would be acceptable to banks only if matters became much worse, that is if continued rescheduling were no longer possible by existing methods, or if the risk of default was increased even further. Fears have also been expressed that the initiating of such actions might give market signals which are harmful to developing countries' future borrowing prospects. Perhaps most fundamentally, the governments of developed countries may be unwilling to back (and/or finance) a supra-national agency which would take over such debts. More modest alternatives which will have less beneficial impact on developing countries, may be more easily implemented. One such proposal calls for central banks or governments to assist interested banks to convert some short-term developing country debts into longer-term assets, leaving the process of renegotiating or rescheduling medium and long-term debts unaltered.

The impact of a possible consolidation and/or rediscounting of private debt would clearly be very positive, in the short-term, on developing countries' prospects for development and industrialization. In this way, a higher proportion of their foreign exchange resources could be released for productive uses, rather than the servicing of past debts.

The more long-term impact would depend on the effect which such measures have on future net private capital flows. Some observers believe that the main impact would be to improve the balance sheets of private banks and thus stimulate new lending to developing countries. The medium and long-term impact would also imply the availability of a larger volume of potential development and industrial financing. However, other observers fear such schemes would have a perverse effect leading to a medium-term worsening of developing countries' borrowing prospects. Therefore, in the long term, such a scheme could potentially be harmful to developing countries' growth and industrialization prospects. However, the negative impact of such measures may be avoided if the consolidation and rediscounting of debt operations could be linked to some more permanent mechanisms. The above-mentioned international lender of last resort facility is an example of such mechanisms which would diminish risk perception for future lending by banks. Naturally the more permanent solution would require, as a necessary quid pro quo, measures which would prevent abuse by private banks. Measures include strengthened supervision and high levels of discount on debt purchased by such an agency.

This system would combine more stable private flows with more appropriate instruments for financing development needs. Thus it will provide a much more solid base for the external financing of development and industrialization. It may be concluded that schemes to generate more sustained private flows, with mechanisms appropriate for developing countries' needs, were unattainable. Therefore, the governments of developing countries should review the extent of their heavy reliance on private external finance for their development programmes. Perhaps they should address the possibilities of attempting to rely more on their own resources.

3.3. Proposals to enhance liquidity of the international economy via the issue of additional SDRs

The Group of 24,[24/] the Group of 77,[25/] the UNCTAD Secretariat,[26/] the 1983 Brandt Commission Report, as well as many observers have stressed the urgency of a sizeable new allocation of SDRs. It is argued that the new issue of SDRs must be large, to compensate for the declines in total international liquidity occurring in the early 1980's. This is particularly serious because at the end of 1981, reserve levels of some 30 developing countries had been reduced to the equivalent of one month's imports or less. The issue of additional SDRs was necessary to help finance deficits if world economic recovery was to be sustained. The 1983 Brandt Commission has pointed out that an SDR allocation has other advantages. It would help restore the deteriorating ratio of SDRs to non-gold reserves to previous levels. More importantly SDR allocations do not create repayment obligations, which is particularly crucial at a time when countries' debt service ratios are so high that many countries are unable to service their debts without major deflation of their economies. Finally, there is the problem of timing. The measures discussed above to enlarge lending by existing official institutions, or by creating new ones will take time to implement whereas there is an urgent need for expanding liquidity, particularly for the developing countries. Several of the proposals for a new issue of SDRs argue convincingly the case for a higher proportion than in the past of this issue to developing countries. However, such a proposal will, undoubtedly, be resisted by the governments of the larger developed countries.

24/ Inter-governmental Group of 24 on International Monetary Affairs, Communiqué issued after 27 April meeting, IMF Survey, 9 May 1983.

25/ The Buenos Aires Platform, Final Document of the Fifth Ministerial Meeting of the Group of 77, 28 March-9 April 1983.

26/ UNCTAD VI, International Financial and Monetary Issues. Policy Paper, (TD-278), Belgrade, June 1983.

A new issue of SDRs is needed not only to sustain growth in developing countries, but also to help avoid production cutbacks in many of them. A new issue of SDRs would benefit both the poorest countries with very limited foreign exchange reserves and the heavily indebted middle-income developing countries. Although not directly geared towards financing of industrialization, such a measure would be of undoubted benefit in sustaining industrial output.

3.4. Proposals to broaden compensatory finance and their impact on developing countries' finance

This section examines the financial measures taken and proposals made to stabilize import capacity of developing countries, as their export earnings fluctuate. The equally important measures and proposals for attempting to stabilize export earnings directly, through mechanisms such as the UNCTAD Common Fund for Commodities and/or individual international commodity agreements will not be dealt with here. They are outside the scope of purely financial measures.

The first change in the rules of the international monetary system that the developing countries succeeded in securing was the introduction of the IMF Compensatory Financing Facility (CFF) in 1963.[27/] It has since become accepted by the international community as a necessary mechanism to mitigate the adverse impact of fluctuations in export earnings of developing countries on their development process. It attempts to maintain unaffected import capacity as a result of export earnings' fluctuations caused by external events. The IMF

27/ Currently, two other compensatory financing schemes are in existence: one is administered by the Arab Monetary Fund; the other, known as STABEX, is administered by the European Community.

CFF provides for low-conditionality drawings to finance temporary shortfalls in export earnings below the estimated trend, subject to limits set by the size of a country's quota and the size of the estimated shortfall.[28/]

In the 1970's CFF became a major facility for providing payments assistance by the IMF to member countries, especially developing ones. The participation of CFF in total use of the IMF credit by developing countries was 44.7 per cent in the period from January 1976 to July 1979 and 27.8 per cent in the period from August 1979 to May 1982). However, borrowing under the facility remained modest considering the terms of trade deterioration experienced by developing countries.[29/] The main problems with the existing modus operandi of CFF are the quota limits on maximum drawings (this is clearly the most important constraint); the calculation of export shortfalls in nominal terms; and a formula for repayments which is not linked to the recovery of export earnings.[30/]

Therefore, the Group of 77,[31/] the UNCTAD Secretariat,[32/] the 1980 and 1983 Brandt Commission Reports have all proposed a liberalization of CFF so

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28/ For more details about the CFF see L.M. Foreux, Compensatory Financing Facility, Pamphlet Series No.34, (IMF, Washington D.C., 1980). A more recent review, with proposals for improvement, can be found in S. Griffith-Jones, Compensatory Financing Facility: A Review of its Operation and Proposals for Improvement, Report to the Group of Twenty-Four, UNDP/UNCTAD, Project INT/81/046, January 1983.

29/ In particular, CFF is reported to have met less than one twenfth of African countries' terms of trade deterioration in the years 1978-81. Source: John Williamson, The Lending Policies of the IMF, (Institute for International Economies, Washington D.C., August 1982).

30/ For more details see S. Griffith-Jones, Compensatory Financing Facility ..., op.cit.

31/ The Buenos Aires Platform, Final Document of the Fifth Ministerial Meeting of the Group of 77, 28 March-9 April 1983.

32/ UNCTAD VI, International Financial and Monetary Issues. Policy Paper, (TD-278), Belgrade, June 1983.

as to provide full coverage of shortfalls. There is also widespread support for the shortfall formula to be reviewed and expressed in real terms (so as to take account of real import capacity rather than nominal one) and for making repayments more closely linked to a country's recovery of export earnings. There is much support for such proposals in academic circles,[33/] which emphasize particularly their counter-cyclical impact both for developing countries and the world economy. It has also been reported that even developed countries' governments may be open to proposals for liberalizing CFF. Therefore it seems quite likely that such proposals may be approved.

A more ambitious proposal to establish a complementary facility to compensate for the shortfalls in earnings of each commodity has also been put forth. This is an additional proposal to the above-mentioned one for the improvement of the IMF Compensatory Financing Facility. The proposed complementary facility is to offer assistance toward financing the additional foreign exchange costs that would be incurred in case domestic stabilization of commodity sectors is to be undertaken. There are important similarities between this proposal and STABEX,[34/] which is currently operated by the European Economic Community (EEC) only for African, Caribbean and Pacific (ACP) states, and which has much more limited resources than those proposed for the new facility.

UNCTAD and the Group of 77[35/] have requested the Secretary General of UNCTAD to convene a meeting for the preparation of a negotiating conference

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33/ See Williamson, op.cit.; also, C. Diaz-Alejandro, "International financial and goods markets in 1982-3 and beyond", International Economic Association, March 1983.

34/ European Communities (EC) programme for helping developing countries under the Lomé Convention. If export earnings fall below a certain level, financial assistance is available from EC.

35/ The Buenos Aires Platform, op.cit.

on such a complementary facility for commodity-related shortfalls in export earnings.

Enlarged compensatory finance - whether it operates by providing general balance-of-payments assistance or assistance to particular sectors - mainly implies sustaining real import capacity in times when export earnings decline due to circumstances outside countries' control. Such measures have shown themselves to be particularly essential, especially in view of the recent dramatic declines in the terms of trade which so many developing countries have experienced. This was largely caused by the deep and widespread recession in the industrial economies since 1980, and the resulting curtailment of growth in developing countries. Expanded compensatory finance, therefore, seems essential in order to avoid curtailment of crucial imports which would disrupt growth and industrialization. As pointed out above, it would provide a very desirable counter-cyclical impact both on developing countries and on the world economy. This would help in breaking the vicious circles of recession and financial distress which have characterized the recent period. By providing substantial flows at times of balance-of-payments difficulties, it would indirectly contribute to alleviate the negative impact of the "debt overhang", and moderate the risk of financial crisis.

Measures to increase international liquidity, provide other forms of general balance of payments financing, or reducing the debt overhang. Similarly, proposals for enlarging compensatory finance would have a clearly desirable impact on developing countries' growth and industrialization prospects. The main impact would probably not be so much in generating new projects. It would probably be on the equally essential task of sustaining growth and industrialization by continuing the advance of existing projects, as well as sustaining the use of current capacity. This is especially crucial at times

when the international environment in which a developing country operates becomes unfavourable. While these measures may not have a direct impact on accelerated industrialization, their indirect impact may be especially critical for some countries, in sustaining the tempo of industrial development.

3.5. Proposals concerned with conditionality

The IMF and the World Bank both impose certain conditions before agreeing to substantial loans - the IMF for its upper tranche lending, the World Bank for its structural adjustment loans. Both types of conditionality have been subject to criticism, and proposals have been made for their reform. The World Bank's structural adjustment loans form only a small part of its total lending. It generally also requires that IMF conditions be met. Therefore, discussions shall be confined to IMF conditionality, which has become of further significance in the last year or so. The commercial sector's willingness to roll over its debts to major borrowers and extent new loans has come to increasingly depend on a country agreeing to an IMF package. It is generally agreed that some conditionality for countries in acute balance-of-payments difficulties is required so as to secure improvement in the external payments position. However, IMF conditionality has been criticized because of:

(a) Designing its conditions at the level of the individual country and not sufficiently taking into account the aggregate implication of its required programmes when carried out in a number of countries;

(b) The objectives implicit in its programmes;

(c) The instruments it considers;

(d) The 'performance' variables adopted.[36/]

36/ See S. Dell, "On Being Grandmotherly: The Evolution of IMF Conditionality", Princeton Essays in International Finance, October 1981; A. Sengupta and F. Stewart International Financial Co-operation: A Framework (Frances Pinter, London, 1982) chapter 6; T. Killick et al. The Quest for Stabilisation and the Third World (forthcoming); and The IMF and Stabilisation: Developing Country Experiences.

3.5.1. Aggregation: The IMF generally treats each country individually. But each country programme has certain effects on other countries. Where a large number of countries are involved, these 'external effects' can be so extensive as to make it impossible to achieve the required structural changes simultaneously. This concerns both demand policies and exchange rate policies. Most IMF programmes involve severe reductions in demand, so as to reduce imports. But each country's imports are another country's exports. Consequently, cutting imports in one country, makes it more difficult for other countries to meet export targets. The emphasis on demand, together with the failure to aggregate, impart a strong deflationary impact to IMF conditions. This is enforced by the fact that the IMF imposes conditions on deficit countries, but not on surplus countries. If surplus countries were also subject to some conditions, they might be asked to spend more and relax import restrictions thus improving the prospects for adjustment among deficit countries through an increase in exports. However, with focus only on deficit countries, all the emphasis is on reduction in demand, and none on expansion. To deal with this problem it is proposed that the IMF should:

(a) Consider the aggregate implications of its conditions on all the countries for whom it devises conditions, and adjust its conditionality accordingly;

(b) Treat the surplus countries symmetrically with the deficit ones. These two changes would have the effect of raising the level of world demand.

3.5.2. Objectives: The IMF puts prime emphasis on two objectives - improved short-run balance-of-payments performance, and control of inflation. Many countries, while sharing these objectives, would put less emphasis on inflation control and more stress on maintaining high levels of employment and output. In this way they would meet the basic needs of the people while acquiring a longer time horizon for the balance-of-payments objective. In fact, these

latter objectives are quite in keeping with the Articles of Agreement of the IMF which are included in the main purposes of the IMF:

> "To facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of policy."

The IMF objectives tend to impart a deflationary bias in conditionality, as compared with objectives which include high levels of employment, basic needs fulfilment and economic growth.

3.5.3. Instruments: The IMF believes that certain instruments are most effective in achieving its twin objectives. They include control of public expenditure, control of the money supply, import liberalization and exchange rate depreciation. Critics generally agree that these instruments do affect the objectives in the direction required, but believe that there are alternative instruments such as foreign exchange and import controls, investment in export industries, which should also be considered. The IMF set of instruments tends to impart a deflationary bias, as compared with alternatives.

3.5.4. Performance criteria: The IMF programmes generally impose certain targets for specific variables, for example, ceilings on total domestic credit and on credit to the government and limits on the acceptance of new external debt obligations. These target variables are often difficult to control, and may be missed for this reason. Yet, often, following lengthy negotiations and after the introduction of tough government policies IMF finance has been withdrawn because of failure to meet the performance targets.

3.5.5. Proposals: The proposals involve changes in the nature of IMF

conditionality so as to meet the criticisms summarized above. Apart from the content of the programmes, it has also been proposed that the method of negotiation should be changed. Instead of the IMF presenting governments with a programme, the programmes should be developed with the active participation of the country concerned together with other interested parties and independent observers.37/ Programmes arrived at in this way would be more acceptable to the country and therefore more likely to be adhered to. They would take into account the countries' own priorities towards the objectives of economic management, and its preferences as to instruments.

A major thrust of proposals for reform is that conditionality should be concerned with structural aspects as well as demand. Formally, supply is now included in IMF programmes, but in practice this has not made much difference because the main emphasis has continued to be on control of demand. Yet, despite attempts in the late 1970's and early 1980's to adapt its programmes to the changed nature of the problem, since the second half of 1981 IMF's conditionality has in most respects been very close to its conditionality say in the late-1960's, with primary emphasis on demand restraint.38/ Supply conditions have been interpreted largely as a matter of price incentives, and not a question of building up investment in potential export and import substituting industries. For many countries the main cause of balance-of-payments problems is not excessive domestic expenditures, but changes in the nature of the world economy (including deteriorating terms of

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37/ See the suggestions of G. Ranis, "Foreign aid: Euthanasia or reform", Worldview, Vol.23 No.3, March 1980; Sengupta and Stewart, op.cit.; and Killick, op.cit.

38/ T. Killick, "The reform of the International Monetary Reform", with special reference to conditionality", Study on the International Financial and Trading System Background Paper, 6, (Commonwealth Secretariat, 1983).

trade and reduced world demand). Thus an appropriate response would be to improve their productive structure, rather than reduce demand.

Alternative conditions for adjustment would vary from country to country, according to their history, specific problems, preferences and opportunities. Consequently, no single alternative conditionality is proposed. But a major emphasis is on policy changes to produce supply increases that will secure improvement in the balance-of-payments in the medium term. Killick has suggested that a general criterion should be that "Fund-supported stabilization programmes ... be consciously set within a cost-minimizing framework."39/

Emphasis on structural changes to secure improvements in the balance-of-payments involves a longer-term perspective than emphasis on demand reduction. There is widespread agreement that IMF finance should be medium-term, rather than short-term, and should also be larger. Indeed, without these changes, the alternative approach to conditionality would not have much possibility of working.

A major criticism of the IMF operations lies in its failure to 'aggregate' as described above. In response to this, it has been proposed that the IMF should take into account the state of the world economy and the aggregate implications of its programmes in devising particular country programmes.40/

39/ Ibid.

40/ R.N. Cooper, "The evolution of the International Monetary Fund towards a World Central Bank", Study on the International Financial and Trading System, (Commonwealth Secretariat, 1983).

It has also been proposed that the IMF should also review its programmes for surplus countries. The Committee of 20 recommended more "effective and symmetrical adjustment procedures" and that graduated pressure be applied to any country in persistent imbalance, whether surplus or deficit. Various suggestions were made as to possible measures to be applied to persistent surplus countries, including, for example, a charge on reserve accumulations, or withholding future SDR allocations.41/

3.5.6. Implications for industrial finance: IMF finance is short-term balance-of-payments support and does not explicitly discriminate between sectors. However, to some extent many of the proposed changes would - at times of world depression at least - involve a more expansionary and less deflationary impact in a large number of countries. Therefore, they would tend (indirectly) to increase industrial finance and also to raise demand for industrial products.

Whether a structural approach to adjustment would favour the industrial sector will depend on the nature of each economy. Any improvement in the balance of trade requires an increase in the production of tradable products relative to their consumption. With a demand approach this is achieved by reducing the consumption of tradables, which often leads to a reduction in production as well. With a structural approach, the emphasis is on an increase in the supply of tradables. The two major elements of tradable production are primary products and industrial products, with the latter generally becoming more significant as development progresses. Hence while a demand approach tends to result in a decline in tradable (including industrial) production, a structural approach will involve an increase in tradable

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41/ Committee of Twenty, International Monetary Reform, (IMF, Washington, 1974.).

production. Industrial production always forms one element of this, but its significance is likely to be greater for more industrially developed countries.

3.6. Proposals concerned with low-income developing countries

Special schemes directed at low-income developing countries, are required for three reasons. First of all, these countries are most in need of development assistance because they have the lowest per capita income, and extreme poverty coupled with lowest life expectancy, highest rates of infant mortality, rampant malnutrition and lowest literacy rates. Secondly, changes in the international monetary system in the 1970's, especially the rapid growth of commercial lending, has reduced low-income countries' relative share of external finance, as compared with middle-income countries. For example, the share of external finance going to all non-oil developing countries fell from 17 per cent in 1973 to 14 per cent in 1980. Thirdly, the structural characteristics of low-income developing countries make them particularly vulnerable to external shocks, and rather inflexible in adapting to such shocks, as compared with most middle-income developing countries. At the same time, because so many people in low-income countries are living on a knife-edge in terms of health and nutrition, quite small changes in incomes and the availability of goods can have devastating effects on their very survival.

Two types of schemes to provide special assistance to low-income countries may be distinguished. First, schemes designed to provide short-run assistance to help in the process of adjustment to external fluctuations. Secondly, schemes designed to increase capital flows to low-income countries and to improve the terms on which they receive it on a long-run basis. The first type of assistance is mainly concerned with the nature of financial

support provided by the IMF. The second with the medium-term sources of finance, including bilateral and multilateral aid flows and commercial flows of capital.

3.6.1. Proposals to improve short-term finance to meet crises: Certain special features of low-income countries make them particularly vulnerable to short-run crises. Their structural rigidities make it difficult for such countries to adjust rapidly through internal changes. In addition, most low-income countries have very limited access to commercial capital markets. It follows that they are especially dependent on IMF finance when they meet financial crises.

The proposed changes, therefore, consist, for the most part, in increasing the volume of IMF finance and more easily accessible. A group of experts proposed the following:[42/]

(a) A doubling of the IMF quotas in the Eighth Review;

(b) That the Compensatory Financing Facility should be untied from quota limitations and related to the shortfall of export earnings calculated in terms of import purchasing power;

(c) The Extended Fund Facility should have its quota limits relaxed. Conditionality should be changed with greater weight on achieving higher real output. The target variables associated with performance criteria should be more flexible;

(d) A special window should be set up as an emergency facility to provide around $US 2 billion a year for five years to provide access for low-income countries which have limited access to commercial funds. Drawings under this window would be concessional, and carry long repayment schedules;

(e) The subsidy account should be increased;

42/ Report of the Experts Group "Low-income countries and the International Monetary System", UNDP/UNCTAD Project INT/81/046, Jan. 1983.

(f) A substantial new issue of SDRs should be made linked to development finance. Allocations should be related to structural trade deficits;

(g) Conditionality should be changed to take account of the special problems of low-income countries, emphasizing supply changes rather than demand reduction.

These proposals - some of which apply to all developing countries and not only low-income ones (e.g. the SDR issue, reformed conditionality; extension of the CFF) - are all related to short-term adjustment. But there is also a need to redirect the flow of resources on a long-term basis, so that a greater proportion go to the least developed countries. Proposals to achieve this include:[43/]

(a) Raising the proportion of aid that goes to low-income countries. In 1979, the proportion of net ODA going to low-income countries was about 45 per cent. It has been suggested that a target of two-thirds should be set for this proportion, which in 1980 values would have involved an additional flow of $US 4 billion of resources to them;

(b) Increasing aid leverage by providing interest subsidies from public funds for private loans to low-income countries; by co-financing between the aid and private funds; and by the provision of guarantees for commercial flows. All these measures are intended to increase the amount of capital flow to low-income countries, for any given amount of aid;

43/ A. Sengupta and F. Stewart, International Financial Co-operation: A Framework (Frances Pinter, London, 1982) Chapter 5.

(c) Increasing the total flow of aid from aid donors, while directing most (or all) of the additional aid to low-income countries. It has been shown that a small proportionate increase in aid would make a substantial contribution to low-income countries' financial situation if all the extra aid went to them.

3.6.2. Implications for industrial finance of proposals to help low-income countries:

None of the proposals - short-term or long-term - are directly concerned with industrial finance. However, indirectly, they have considerable implications for industrialization and industrial finance. Both in the short- and the long-run, industrialization among low-income countries depends largely on their overall economic strategy and the general financial situation. The greater the availability of finance, the greater will be the rate of industrial expansion. On the other hand, a severe financial problem, leading to a cut-back in investment and output will affect industrial projects particularly acutely. Among countries with lower per capita incomes other than China and India, growth in GDP fell from 4.4 per cent per annum for the period 1960 to 1970 to 3.5 per cent per annum for the period from 1970 to 1980. But the fall in the growth rate of industrial output was much greater from 7.0 per cent per annum in the decade 1960-1970 to less than half, 3.2 per cent per annum in the following decade. Reduced access to external finance means a tightening of restrictions on foreign exchange, which affects inputs for existing activities, as well as new investment projects. There is some evidence that input for existing projects is affected particularly badly, because it is often easier to raise finance for the foreign exchange component of new investments, than to support existing activities.[44/]

44/ ILO, Basic Needs in Danger: A Basic Need Oriented Strategy for Tanzania, 1982.

The short-term crisis proposals, summarized above, would lessen the need for low-income countries to cut back on investment and output while making the required adjustments. From this point of view, all the proposals would ease the financial aid, especially, foreign exchange problems of the industrial sector and permit more finance for new projects. Combined with this general relaxation, the proposals also involve restructuring of low-income economies so as to lead to an improved external financial position in the medium term. In general, this restructuring involves an expansion of the supply of exportables and of import substitutes. For many low-income countries, especially those in Sub-Saharan Africa, the main emphasis is likely to be on raising output in the agricultural sector[45/] which supplies the most exports. Manufactures accounted for only 6 per cent of exports of low-income countries in Sub-Saharan Africa in 1978, and the prospects for a major expansion of manufacturing exports are rather small. The industrial sector enters into the picture as a processor of primary products, and in order to provide essential input for the agricultural sector (e.g. fertilizers, tools, and also consumer goods for rural producers). For these countries, then, where manufactures form only a small element in potential exports, a restructuring programme will be concerned with a redirection and increase of manufacturing output. The aim would be to generate increases in the exports of the primary sector, and increases in the production of food, so as to reduce food imports. Other low-income countries are exporting a significant amount of manufactures. In 1979, for example, 61 per cent of Indian exports were manufactured products. For such countries, restructuring to improve the external financial position will involve the manufacturing sector more centrally, as the major source of additional exports. Therefore, in the first

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45/ World Bank, Accelerated Development in Sub-Saharan Africa, 1981.

group of countries with minimal industrial exports, the additional finance for restructuring will be mainly directed at the agricultural sector. But in countries such as India and Sri Lanka much of the extra finance will go to the industrial sector to improve the supply of industrial exports.

The longer-term proposals summarized above all involve increasing the medium-term access to external finance of low-income countries, thus permitting a greater rate of investment. While it is generally concluded that the agricultural sector requires a greater proportion of new investment than it has received in recent years, a higher rate of investment will certainly involve an increased rate of industrial investment as well.

From 1961 to 1982, total flows of the International Development Association (IDA) (the soft loans of the World Bank) totalled $US 26,738 million of which $US 2,906 million were for industrial projects and $US 910 million for development finance companies (which lend mainly for industrial projects). Thus 14 per cent of the total commitments were directly related to industrialization. It might be expected that the proportion of extra aid going to the industrial sector would be at least the same as this (14 per cent). The other schemes to increase aid leverage, involving e.g. co-finance or interest subsidies to private loans, would be certain to require a higher element of industrial finance because the private sector tends to be more heavily engaged in the industrial sector. Hence we might expect these proposals to be associated with e.g. a 30 per cent element of industrial finance. With industry accounting for 39 per cent of GDP in India and China and 17 per cent in other countries with lower per capita income, the figures just mentioned (14 per cent of aid, and 30 per cent of aid-related finance) seem rather low. This is especially true in the light of the growing significance of the industrial sector among low-income countries (rising from 18 per cent to 35 per cent of GDP between 1960 and 1980). The

fungibility of finance, discussed earlier, must modify this conclusion somewhat. But it can be tentatively concluded that the proposals to assist low-income countries may not make adequate provision for industrial finance. But for many low-income countries, agricultural development and the provision of social services, rightly, has high priority in the short term.

3.7. Proposals for South-South co-operation

There has been an increasing call for greater South-South co-operation in trade and finance in recent years. This is partly a response to the widespread view within the South that little progress has been made in North-South negotiations. In addition, the slowdown in growth in the North and increasing protectionism, led to the view, powerfully expressed by Arthur Lewis,[46/] that the South should become its own 'engine of growth'. This implies that a process of export-led growth should follow from expansion of trade between economies of the South rather than relying on expansion of Northern markets. The concept of self-reliance is an important element in the New International Economic Order. South-South ties provide a logical development of this concept. South-South trade potentially allows developing countries to exploit economies of scale and the productivity gains resulting from specialization and division of labour, while permitting continued protection for South industries from competition from the North.[47/]

Initially there was much talk about the need for South-South arrangements but few concrete proposals. However, recently there has been a

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46/ W. Arthur Lewis, "The slowing down of the engine of growth", American Economic Review, Vol.70 No.3, 1980, pp. 555-564.

47/ See F. Stewart, "Recent theories of international trade: Some implications for the south", Monopolistic Competition in International Trade, H. Kierzkowski ed. (Oxford University Press, forthcoming)

spate of proposals,[48/] more or less well developed and articulated. The proposed reforms are designed to meet a number of identified needs. Some of the proposals cover more than one of the needs. The main areas that have been identified as requiring changes in existing institutions or new institutions are:

(a) The direct recycling of funds from the capital surplus developing countries to the oil-importing deficit countries. The basic idea behind most of these suggestions - discussed in detail in the section on recycling - is that the intermediary role of the North in the recycling process is neither necessary nor desirable. With the disappearance of the OPEC surplus, these schemes have temporarily lost much of their direct relevance, but some aspects are included in the proposals for South-South co-operation;

(b) Finance to meet short-run balance-of-payments problems;

(c) Finance (and other changes) to assist in commodity price stabilization;

(d) Finance of projects (especially for joint ventures among countries of the South);

(e) Schemes to ease the financing of exports;

(f) Schemes to ease payments and promote trade between countries of the South.

These needs for finance are generally shared by virtually all oil-importing developing countries (and many oil-exporting countries). However, while the needs identified are real ones, the possibility of South schemes to achieve them seems limited. The use of OPEC surpluses provided one

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48/ See D. Avramovic ed., South-South Financial Cooperation, (Frances Pinter, London, 1983); and A. Sengupta and F. Stewart, International Financial Co-operation: A Framework (Frances Pinter, London, 1982) Chapter 5; and South, July 1983.

possibility. But when the surpluses were large, OPEC countries were not sufficiently convinced of the desirability of using them in this sort of way. As surpluses diminished so did the prospect of basing viable schemes on them. This leaves 'bootstrap' schemes, with only limited reliance on OPEC funds. Can countries which are themselves in need of finance assist others in a similar position? Much depends on the nature of the proposed schemes. Some require little or no 'hard' currency. For others - especially those involving support for balance-of-payments financing - the possibility of mutual assistance among countries of the South depends on the extent to which their problems occur simultaneously. Many developing countries' balance-of-payments have common origins - in, for example, the state of the world economy, the level of international interest rates, commercial banks' willingness to lend - but others depend on each country's own particular history and fortunes. This leaves some potential for assistance between countries of the South according to the precise state of their economy, international creditworthiness and payments position.

Moreover, the South collectively may be in a stronger position to borrow on international capital markets than individual developing countries. Consequently, a collective effort may enable the South to borrow from the North for balance-of-payments and other types of support.

3.7.1. General Proposals: There have been a number of proposals for new institutions to fulfil the various needs which have been identified. Recently, many of these have been brought together in a proposal for a 'South Bank'. However, some individual schemes that have been proposed in the past to meet each of the specified needs will be discussed before

considering the South Bank. A South-IMF has been proposed,[49] to provide short-run balance-of-payments assistance to countries in acute difficulties. The South-IMF would be financed by contributions from member countries (like the actual IMF). It would provide short-run assistance only, expecting repayment, and imposing its own conditionality. Less ambitious, but on similar lines, it has been proposed that "developing countries' central banks should explore the possibilities for increasing use of deposits with one another as a means of bolstering the ability of these countries and particularly structurally disadvantaged developing countries, to withstand crisis-related shocks". [50] Furthermore, "developing countries in a position to do so should create or expand regional soft loan funds."[51]

Some of the 'recycling' proposals, discussed above in Section (3.1.), involve expanding existing institutions or creating new ones. The purpose is to provide a direct flow of finance from surplus countries in the South to deficit countries, without relying on the intermediation of North institutions. Some of the proposals involve adding to the financial flows by using the financial power of the institutions to borrow on international capital markets. The most prominent of these proposals was that of Algeria and Venezuela for a South Development Agency based on a development of the OPEC Fund for International Development.[52] The authorized capital of

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49/ Sengupta and Stewart, op. cit., p. 188.

50/ Report of the Experts Group "Low-income countries and the International Monetary System", Report of the Experts Group, UNDP/UNCTAD Project INT/81/046, January 1983.

51/ Ibid.

52/ Joint proposal by the Algerian and Venezuelan delegations on "The Need for Additional Financial Co-operation between OPEC Member Countries and Other Developing Countries", submitted to the OPEC Ministerial Meeting in Caracas, December, 1978.

the Agency was proposed at $US 20 billion, of which half would be called in. It was intended to provide long-term finance for development projects, on both concessional and non-concessional terms.

Export credit refinance and guarantee facilities for exports from the South have been proposed[53/] to enable such transactions to enjoy the financial facilities now generally available in the North. New international facilities could refinance export credits provided by national governments of the South. Alternatively, an international guarantee facility could be introduced which would permit commercial refinancing. Some proposals confine these facilities to South-South trade, while others extend them to exports to all markets. It is normally assumed that these facilities would apply to industrial products only (both traditional and non-traditional). Some proposals suggested that some form of subsidized credit should be incorporated.

Various proposals have been put forward to ease trade and payments among developing countries.[54/] These include a clearing union, which would economise on the use of hard currency in trade between developing countries. A clearing union would provide a small element of short-term credit between Members, to cover the interval between the delivery of goods and making the net foreign exchange payment. A variety of proposals have also been made for developing countries payments unions, involving a more substantial extension of credit between member countries.

53/ A. Sengupta, "The structure of international finance and the less developed countries",(United Nations, New York, 1977)(mimeo); and J.D.A. Cuddy, "Export credit" and A. Nguyen, "Export financing in developing countries", in D. Avramovic ed., op. cit.; "Evaluation of the operational features of an international export credit guarantee facility", TD/B/C.3/183 Add.2, January 1983; and documents quoted in Section 3.1.

54/ Sengupta and Stewart, op. cit., pp. 177-188

There are a number of alternative types of payments union. A central feature is that trade between members (the developing countries who join the scheme) would be financed through the union. Credit would be extended and only the net balance would be payable in convertible foreign exchange. The existence of credit and the savings in using convertible currency for intra-South trade would encourage countries to expand trade between each other. One variant of a payments union-type arrangement is for the issue of South Money,[55/] which countries would use in part payment for trade with each other. Like other proposals, this would have the effect of reducing the hard currency cost of transactions between members, thus encouraging trade expansion. All such monetary schemes would facilitate intra-South trade. However, consequent changes in tariffs, transport, etc., may be necessary to bring about an actual redirection of trade.

3.7.2. The South Bank

The proposal for a South Bank was first mooted at a Group of 77 experts meeting held in Jamaica in March 1982. After a follow-up meeting UNCTAD was asked to provide technical documentation. The resulting papers[56/] make wide-ranging proposals, detailing functions and finance. The proposed bank would incorporate many of the functions that the earlier proposals were intended to perform.

(a) Finance: It is proposed that the South Bank should be established with a total capital of $US 38 billion, of which $US 4.8 billion would be paid-in capital and the rest would be on call. Of the paid-in capital,

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55/ F. Stewart and M. Stewart, "A new currency for trade among developing countries", Trade and Development, UNCTAD, 1981.

56/ Technical documentation for "The study of the feasibility of a Bank for Developing Countries", UNCTAD, May 1983.

$US 1.5 billion would be in convertible foreign exchange and the balance in national currencies. Hence developing countries would be making a direct contribution in convertible foreign exchange of a small fraction of their total reserves (1.5 per cent of non-oil developing countries' reserves in 1982). It is proposed that on the basis of these contributions the bank would be able to borrow on international capital markets so as to permit it to lend the full amount ($US 38 billion). Its total lending activities, therefore, would be 25 times as great as the paid-in foreign exchange.

(b) Functions: It is proposed that the Bank should fulfil all of the needs identified earlier:

(i) The finance of development projects, including joint ventures;

(ii) The provision of export credit and/or export credit guarantee;

(iii) Balance-of-payments support;

(iv) Finance for commodity stabilization;

(v) Support for regional payments and credit arrangements.

The provisional figures show balance-of-payments support using about 44 per cent of resources, joint ventures 20 per cent, export credit 18 per cent, commodity stabilization just over 10 per cent, mining and processing investment 8 per cent, and support for regional payments arrangements less than 1 per cent.

Most of the activities of the bank would consist in non-concessional lending, which is essential for it to maintain its financial viability. However, an interest subsidy account, to which contributions would be voluntary is also proposed. For balance-of-payments support, the bank would introduce its own conditionality.

The details of this conditionality are not spelled out beyond the possibility of the developing country making a commitment to undertake special measures to promote co-operation with other developing countries and "through this device carry out most of the balance-of-payments adjustment."

There are several questions that should be closely examined in relation to the South Bank as currently envisaged. Among these is the question of how to ensure its financial viability. Although apparently based on the cautious gearing ratio of 1:1, the proposed ratio of lending to paid-in hard foreign exchange reserves is over 25:1. It is not clear that the bank would be able to borrow anything like as much. A ratio of, for example, 3:1 seems more reasonable, particularly in the first few years. Also, it must be made clear how many of the identified needs the South Bank could meet without over-extending itself. Furthermore, some of the functions are already met, partially, by other institutions and many would favour expanding these activities rather than starting a new institution.

There is undoubtedly both need and desire for new South institutions; and a potential for the South to exploit its collective strength. A South Bank, focusing, initially at least, on a narrower set of functions and with a lower ratio of lending to paid-in hard currency could provide useful finance and promote developing countries' collective activities.

3.7.3. Implications for industrial finance: The implication of the various proposals for South-South co-operation may be easily analysed by considering the various functions that are to be performed. The implications are much the same whether the functions were to be performed by separate institutions or by a single institution such as the South Bank.

(a) Short-term balance-of-payments assistance provided from within the South. This has been suggested as a separate institution, and also forms a

major part of the proposed South Bank. The precise implications will, of course, depend on the constitution and objectives of the new institution. A general feature of any such assistance would be a new type of conditionality. The issue of conditionality has already been discussed in Section (3.5.). Therefore, it is likely that while conditionality of a South-IMF would have to be strict, in order to make the institution viable over the medium term, it would have some major differences from standard IMF-style conditionality. It is likely that balance-of-payments support from a South Bank would place significantly more emphasis on growth and development and less on inflation control than the IMF. Its conditionality, just like IMF's would have to aim for a turn-around in the balance of payments. However, it would also emphasize a turn-around involving the increase and restructuring of supply, rather than reducing demand. The net effect is likely to be less downward pressure on industrial output and investment, with considerable emphasis on restructuring.

In the proposal for balance-of-payments assistance in the documentation on the South Bank, reference is made to alternative conditionality. However, the only specific element mentioned is the issue of adjustment through co-operation with other developing countries. To the extent that this is possible, it would be likely to redirect trade towards the South, probably largely in relation to industrial products. However, in view of the fact that the developing countries collectively have a large trade and payments imbalance with the rest of the world, some of the adjustment may need to take the form of increasing exports to the North.

(b) Financial support for projects for development with special emphasis on joint ventures. Quite a substantial portion of the South Bank lending is intended for this purpose (a total of $US7.6 billion according to the provisional estimates). A very high proportion of these projects is likely

to be in the industrial sector. It would seem reasonable to estimate one-half to two-thirds of the total - i.e. $US 3.8 billion to $US 5.1 billion - as earmarked for industrial projects.

(c) Export credit and export credit guarantee schemes. Schemes which ease the financing of exports (the credit refinancing facility) are likely to be directed to industrial products and not primary commodities. It is the absence of credit facilities for industrial products that causes a major problem. Hence while such facilities will not directly finance industrial exports, by extending credit facilities for the sale of industrial exports they will, indirectly, be providing industrial finance. According to one estimate,[57/] non-traditional exports from developing countries will be $US 71 billion in 1985, and traditional exports traded within the South are expected to be about $US 49 billion in 1985. Export credit schemes would apply to both these categories. It is estimated that $US 87 billion would be required for finance/refinance and $US 21.7 billion for guarantees. This assumes that the facilities do not apply to intra-firm trade, nor trade which is financed by existing facilities, with direct finance or refinance for 20 per cent of the remaining exports and guarantees for the rest. Traditional exports - i.e. manufactures - would receive about half of this finance. The South Bank proposal involves a much more modest commitment of finance of $US 6.7 billion). The discrepancy between this figure and the estimates of requirements made by those looking at export credit facilities on their own reinforces the conclusion that it might be better to separate these functions.

57/ J.D.A. Cuddy, "Export Credit", South-South Financial Co-operation, (Frances Pinter, London, 1983) p. 109.

The South Bank was established as a facility to finance balance-of-payments assistance and projects, while an independently financed export credit/ guarantee facility is also set up.

(d) The schemes which are intended to ease payments for trade between developing countries are likely to have their main effects on manufactured products. While the schemes may extend to primary products, it is likely that their greatest effects will be on manufactures. The potential for expansion of trade between developing countries in response to schemes of this type is highest for manufactured products.

The rate of expansion of trade in the South in primary commodities depends mainly on their aggregate rate of growth. However, there is limited scope for substituting South-produced for North-produced primary commodities (although there is some potential). The greatest potential lies in manufactured products, where there is a possibility of expanding trade in two ways. First, by substituting South-manufactured for North-manufactured products. In many areas, the South manufactures products of a similar type to those imported from the North. The present foreign exchange problems are causing a clamp-down on imports from North and South. For example, exports of buses and trucks from Brazil have been cut by two-thirds in 1982 as compared with 1981, largely because of the reduction in markets in the rest of Latin America.[58/] But, if the payments situation with other developing countries were eased, there would be a strong inducement to be selective in imports, cutting down on North products and switching to South imports. Secondly, in manufactures developing countries could increase

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58/ A significant decline can also be seen in the agricultural machinery industry, as shown in "A survey of the Latin American Agricultural Machinery Industry", UNIDO/IS.407.

their specialization and division of labour, raising productivity and exploiting economies of scale, by relaxing trade restrictions between themselves.

The extent of additional finance provided by such schemes will depend on the particular scheme adopted. Assuming that the schemes were intended to increase trade in manufactures between developing countries by one-third, then it might be said that the credit provided by the schemes should be of a similar magnitude, or around $US 4.7 billion at 1978 values.59/

(e) Support for commodity price stabilization. This forms only a small element of the South Bank, although it is, of course, a major part of the proposals for the New International Economic Order. Such schemes do not provide any industrial finance - but in so far as they generate extra flows of finance in total, and/or permit a more sustained rate of economic growth at a world level, they make an indirect contribution.

4. STABILITY AND GROWTH IN THE WORLD ECONOMY

Developed (market) economies provided 51 per cent of the markets for low-income countries exports and 64 per cent of the markets for middle-income developing countries in 1980. For manufactures, developed market economies accounted for 43 per cent of low-income developing countries' exports and 63 per cent of middle-income developing countries' exports in 1979. The

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59/ F. Stewart and M. Stewart, "A new currency for trade among developing countries", Trade and Development, UNCTAD, 1981, p.80.

rate of growth of demand among developed countries, therefore, has a critical influence on the growth in markets for exports of developing countries. Stagnation in developed countries not only affects the total size of the world market, but causes a swing towards protectionism among developed countries making it more difficult for developing countries to maintain their share of the market. Moreover, a reduction in demand for primary products affects both quantities sold and also the prices at which they are sold, so that the terms of trade turn against producers. Finally, the recent recession among developed countries was accompanied by high interest rates, increasing the burden of developing countries' debt. The balance-of-payments position of developing countries was, therefore, squeezed from all sides. With the recession among developed countries export earnings were reduced while interest obligations increased. Regression analysis relating growth among developing countries to growth among developed countries for 1960-1977 showed that for every percentage point decline in developed countries' growth that of developing countries declined by 0.23 per cent.60/ Another exercise showed that a 1 per cent increase in developed countries' growth would be associated with a 2.3 per cent increase in developing country exports to developed countries.61/ Output of the major developed countries is estimated to have fallen by 0.25 per cent in 1982, while developing countries' exports fell by 2.3 per cent. The achievement of sustained recovery in the world economy is probably of greater significance than any other change for the prospects of developing countries. Sustained growth in the world economy would allow developing countries to enjoy a rapid growth in exports and improved terms of trade,

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60/ William R. Cline, World Inflation and the Developing Countries, (Brookings, 1981.)

61/ M. El-Erian, St. Anthonys, Oxford (mimeo).

thus permitting them to finance much of their development out of earnings. At the same time they would improve their prospects for securing finance because of the additional export earnings.

Fears of inflation are widely seen as a major obstacle to policies among the major developed countries to promote recovery.62/ Hence policies related to inflation - both to reduce its likelihood and minimize its costs - form one aspect of proposals to generate sustained economic growth in the world. As one element of this - and as a cause of instability - the fluctuating exchange rates of the last 10 years or so are of central policy concern. Policies to promote greater exchange rate stability are sometimes viewed as necessary for greater economic stability in the world. Lack of co-ordination among the major developed countries is regarded as a prime cause of instability and stagnation. As a result, various policies to increase co-ordination have been advanced. Finally, it has been argued that a basic element responsible for the present world disarray is the fact that policies are developed by national governments without due consideration for their international repercussions.63/ World institutions with extended powers and responsibilities are proposed to counterbalance this.

4.1. Proposals for world stability and recovery

4.1.1. Inflation: Views as to the most effective way of controlling inflation differ widely according to the theoretical framework adopted. In particular, there is a major division between monetarist and structuralist type explanations of inflation. At the international level, monetarists regard

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62/ F. Stewart, "Inflation and recovery", UNDP, 1983.

63/ M. Stewart, Controlling the Economic Future, (Harvester Press, 1984).

the international money supply as being the critical determinant.[64/] It is proposed that national co-ordination in monetary policies together with appropriate policies towards the creation of international money are necessary to control inflation. However, so far no major country has appeared willing to lose control over its national monetary policies, for the sake of international co-ordination. Moreover, there is an evident conflict between this type of inflation-control, which favours tight monetary policies, leading to high interest rates, and promotion of international recovery. In addition, it has been persuasively argued that governments do not have effective control over money supply at the national level, and even less so internationally. In fact, the money supply adapts itself to demand which depends on many factors, including the structural elements behind inflation. Both institutions, such as trade unions (nationally) and producers organizations (internationally); and supply rigidities, as in energy and food bottlenecks, are seen as structural causes of inflation. These structural elements tend to be especially powerful in leading to inflation when demand is rising to high levels in relation to capacity. National issues include incomes, food and energy policies. International policies have centred on controlling the rate of increase of commodity prices, and especially oil, as demand rises. There have been a great number of commodity price stabilization schemes suggested. They are intended to moderate or eliminate price fluctuations. Thus incomes of primary producers would be reduced at times of depression tending to reduce the recession, while moderating the upward effects on prices and demand during a boom.[65/] Special proposals have been put forward to help control

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64/ See Ronald I. McKinnon, Money and Capital in Economic Development (Brookings Institution, 1973); Ronald I. McKinnon, Money in International Exchange Convertible Currency System (Ocford University Press, 1979).

65/ For example the scheme of A.G. Hart, N. Kaldor and J. Tinbergenm "The case for an International Commodity Reserve Currency", UNCTAD, 1964; B.B. Bosworth and R.A. Lawrence, Commodity Prices and the New Inflation, (Brooking Institution, 1982); and the Integrated programme for Commodities in the proposals for the New International Economic Order.

the price of oil. These consist of some sort of contract between industrialized countries and oil-producers to agree on an oil-price in terms of manufactures (a stable price or a slowly rising one), and to index the nominal oil price to the price of manufactures.

Both sets of proposals - commodity price stabilization and oil-price stabilization - would probably moderate the rate of international inflation, reduce fluctuations in the rate and also fluctuations in international demand. However, it looks very unlikely that any effective policies of this kind will be introduced. When prices are low during the recession, the industrialized countries resist agreements which would be price raising, while during a boom the producers are similarly loathe to accept price falls. Moreover, as shown by the many 'failed' individual commodity stabilization schemes, they are very difficult to administer, and often collapse when they run too much counter to market forces.

4.1.2. Exchange rate stability: Volatile exchange rates have been regarded as conducive to a greater rate of inflation and inimical to the steady expansion of trade. The Brandt Commission and the IMF have both argued for greater stability. While there is evidence of considerable overshooting in exchange rates,[66/] there is not much evidence that this has had substantial adverse effects either on inflation or trade and growth.[67/] For greater exchange rate stability to be a realistic policy, a convergence in macro-economic policies among the relevant countries, particularly in relation to

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66/ C. Johnson, Lloyds Bank International Financial Outlook, February 1983.

67/ See summary of evidence in V. Cable, "Exchange rate fluctuations: Causes; consequences; means to greater stability", Paper for the Study on the International Financial and Trading System, (Commonwealth Secretariat), March 1983.

rates of inflation seems to be required. In the absence of such convergence, exchange rate stability may not be possible. Even if it were achieved it would not necessarily be desirable, because it would subject countries to exchange rates out of line with their relative costs, and hence cause trade imbalances.

Policies which have been suggested to reduce exchange rate fluctuations include national exchange rate interventions; national policies to limit capital flows; regional currency arrangements, reducing the exchange rate fluctuations among a specific group of countries, such as the European Monetary System; and multilateral policies to achieve greater stability through IMF surveillance of national policies and closer co-ordination of monetary policies among the main trading partners.

To be effective these policies generally require prior policy convergence among the relevant countries which is often lacking. Whether greater convergence is desirable from the point of view of international recovery will depend on whether it focuses on planned reflation or planned deflation. Hence it is not possible to analyse the implications for industrialization independent of the nature of such convergence. Convergence towards co-ordinated expansion (to be discussed below) would be accompanied by greater exchange rate stability. Together these policies would contribute to sustained industrialization. But such stability would, in large part, be the outcome of the convergence and co-ordination of policies rather than its cause. As far as developing countries are concerned, the system of floating exchange rates has had costs, but these may well be less than the alternatives.

4.1.3. Co-ordinated world expansion: In the current world system, any one country implementing expansionary fiscal and/or monetary policies independently is likely to get into difficulties. With expansionary fiscal policy the probability of imports rising faster than exports tends to lead to immediate exchange rate depreciation, while expansionary monetary policy leads to capital outflow and pressure on the exchange rate. Lack of co-ordination tends to lead to a deflationary bias in the world system.[68/] Co-ordinated expansion of the major developed countries, however, would avoid much of this tendency. Exports would tend to rise as well as imports and simultaneous pursuit of expansionary policies would avoid speculation against any particular currency or speculative capital movements among currencies. Co-ordinated expansion does not necessarily mean that every country expands at the same time or pace. It implies that expansion be planned and co-ordinated among the major developed countries to avoid the penalties falling on a country which tries to seek expansion alone.

One way of achieving a form of co-ordinated expansion is through a 'massive' transfer of resources from the developed countries to developing countries whose consequent extra expenditure would raise incomes throughout developed countries. This is the thrust of the proposal of the Brandt Commission. Another is for a number of developed countries to expand through internal policies in a co-ordinated way; this has been recommended by a number of Organization for Economic Development and Co-operation (OECD) reports and most articulately in a statement by 26 economists from 14 countries detailing appropriate expansion in the major developed countries.[69/]

68/ M. Stewart, Controlling the Economic Future, (Harvester Press, 1984).

69/ "Promoting world recovery, a statement on global strategy", (Institute for International Economics, Washington, December 1982.)

A similar proposal was made by the Bank of International Settlements[70/] calling on Germany, (Federal Republic of), Japan, United Kingdom and United States to lead a world economic revival by expanding domestic demand, acting as "buyers of the last resort".

It is not lack of machinery, nor of ideas, that is preventing such proposals from being realized, but rather political and economic strategies among certain countries. Essentially most of these countries give higher priority to control of inflation, control of public expenditure and of the money supply, than economic growth as an objective. One major reason is that they consider only the national and not the international consequences of their actions. To counter this, various proposals have been made for extension of powers of international institutions to offset the deflationary impact of national policies. These involve transforming a reformed IMF into a World Central Bank, with responsibility for the world's economic health of a similar nature to that of national central banks.[71/] However, some proposals go further than that seeing the desirability of an international institution with powers and responsibilities not only of a World Central Bank, but also a World Treasury (i.e. with responsibility for fiscal as well as monetary policy).

The need for the 'lender of the last resort' function was discussed earlier in relation to the debt situation. It is clear that the present system of unco-ordinated lending with no systematic safety net for lenders or borrowers, but ad hoc arrangements devised at the last minute, threatens the stability of the whole system and discourages lending.[72/] It has a

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70/ BIS, 53rd Annual Report, (Basle, Switzerland, June, 1983.).

71/ R.N. Cooper, "The evolution of the International Monetary Fund towards a World Central Bank", Study on the International Financial and Trading System, (Commonwealth Secretariat, 1983.).

72/ M. Lipton and S. Griffith-Jones, "International lenders of last resort: Are changes required?". Background paper for the Study on the International Financial and Trading System, (Commonwealth Secretariat, March 1983.).

major deflationary impact, potentially, as would occur if the banking system collapsed; and also, actually, in terms of the slowdown in lending that has occurred with fears of collapse. In effect, BIS and the IMF have been acting as lenders of last resort in particular cases, with occasional assistance from certail national treasuries. While this has prevented massive collapse, it has not prevented the deflationary bias caused by extreme caution about new lending. A World Central Bank, with the function of lender of the last resort to be exercised with discretion, to avoid the 'moral hazard' that can occur with automatic rules, would enable a more orderly and less panicky, reaction to world debt problems. This would also permit a higher level of international lending. The bank could also take on the functions of 'debt manager' transforming maturities as thought necessary. A lender of the last resort, however, can only function as such if it has unlimited resources at its disposal. An ordinary central bank can issue domestic currency indefinitely. A World Central Bank would also need the same potential, either by being allowed an indefinite issue of SDRs, or by an appropriate commitment of national currencies. To date the IMF has been prevented from acting as lender of the last resort partly by the limitations of its resources.

The lender of the last resort function is mainly intended to prevent panic and crash. In addition, a World Central Bank should be able to affect world spending by its influence on liquidity and interest rates. It could influence both by regulating the issue of SDRs, its own call on and use of national currencies according to the state of the world economy, and by direct regulation of commercial banks. For the last, new powers over commercial banks would be required, which would be difficult to enforce. But the first two would only involve a development of existing IMF activities. Up to now, the IMF has not seriously addressed the problems of

getting surplus countries to spend more, but has rather focused on getting deficit countries to spend less. Moreover, it has not tailored its individual country advice to the state of the world economy when multiplied in country after country. Therefore to fulfil the functions of a central bank, the IMF would require a major reorientation.

4.2. Implications of proposals for world recovery for industrial finance

The effectiveness of proposals aimed at restoring growth in world output, would have a very substantial positive effect on industrial markets for developing countries. As world rates of output recover, levels of savings would also rise, and so would the availability of finance. There is no direct 'industrial financing' element in the proposals. However, the improvement in debt management and the reduced fears of collapse engendered by 'lender of the last resort' function would raise the availability of industrial finance from commercial sources. Hence these proposals would certainly increase the supply of industrial finance. They would also raise the demand for finance by improving the prospects for industrial projects in developing countries. It is difficult to be sure of the net outcome because both supply and demand effects have to be taken into account.

Among the many suggestions considered above, the proposals designed to reduce instability (of commodity prices, and of exchange rates) seem least likely to be effective. The proposals to expand world demand through international co-ordination of national policies could be very effective, raising levels of world output substantially. The Central Bank functions are unlikely to have much influence in the short run because of the magnitudes involved. In 1982, IMF finance accounted for 16 per cent of non-oil developing country deficits and a negligible proportion of world income. It is unlikely that these magnitudes could be sufficiently extended in

the short- to medium-run to have anything like the sort of effect that co-ordinated national expansion would have. However, once introduced, the scope could be gradually expanded, so that world economic health would no longer be subject to sudden changes of national policy making.

5. CONCLUSIONS

Most of the schemes for financial reforms would have positive effects on the industrial sectors of developing countries. However, the nature of these effects differs from scheme to scheme. For some, the main result is not the creation of new forms of finance, but of increasing markets for industrial products. There is also a distinction between direct and indirect effects for both markets and finance. Certain schemes will directly increase the flow of finance to industry. Others may increase commodity finance in the first instance but indirectly contribute towards industrialization, by releasing finance for industry and extending markets for industrial products. The indirect nature of the effects of some scheme does not mean that they are necessarily smaller in magnitude than those schemes whose main effects are direct. Moreover, as far as the rate of industrialization is concerned, the effects on markets may be of as much significance as effects on finance.

It has become clear, in the course of examining the implications of the various proposals, that while most would have positive effects on industrial finance, directly or indirectly, it is normally not possible to make a precise prediction of the effects. This is partly because many of the schemes are rather vague, and that their actual effects will depend on the details of their operations. Furthermore, it is often not possible to estimate how far the extra finance will be truly additional. It may, in part or whole, displace other forms of financial flow internationally, and also shifts may occur in the sectoral composition of other flows. Therefore, the sectoral consequences may differ from the apparent direct effects.

Any scheme which contributes towards economic growth in developing countries will also contribute towards industrialization. Industrial output forms a growing element in both production and consumption in developing countries. Consequently, a large part of any unallocated foreign exchange and finance tends to go to the industrial sector. Even some finance that is formally allocated to other sectors finds its way to the industrial sector. The high income elasticity of demand for industrial products in developing countries means that markets for industrial products rise more than proportionately with additional income, irrespective of their origins. Conversely, when income is cut - as in many countries in the last year or so - the industrial sector is most adversely affected.

Over the past few decades, interdependence between North and South has risen as evidenced in the fields of finance, trade and technology. As a result, prospects for much of the South, today, depend critically on developments in industrialized countries. In particular, the present recession in the North is adversely affecting the volume of exports from the South, both in primary products and manufactures. The terms of trade for primary products have deteriorated very substantially, while tight monetary policies in the North are vastly increasing the financial burden of existing debt and the cost of new borrowing. Schemes which contribute to a sustained recovery in developed countries will make a major contribution to the prospects for industry in developing countries. The main positive effects would come from increasing foreign exchange earnings, as export volumes increase and prices of primary products recover. Recovery in the North might also be associated with greater availability of finance, as savings rise with rising incomes. The effects of schemes which contribute to such recovery will be indirect, and mainly affect markets rather than finance. Nonetheless, these effects could be substantially greater, in

terms of the size of the consequent increase in industrial output in developing countries, than those of schemes more directly concerned with the provision of industrial finance.

In examining and comparing different schemes, one needs to consider not only their potential effects, but also how likely they are to be put into operation. The issue can be examined in an a priori way, considering who would gain and who would lose by the various schemes, and the power and effectiveness of the various actors. But there is also actual experience to go on. Many of the proposals have been around for some time. There has been some action on a few schemes, but generally of small magnitude, compared with the recommendations. For example, the transfer of funds channelled through the major multilateral institutions did increase during the 1970's but comparatively little compared with the needs. There was some reform of conditionality in the late 1970's, but it was very minor in comparison with the changes suggested by certain critics. There appears to have been a retreat on this issue since mid-1981. There were many proposals for new institutions in the 1970's but with little progress. Some have argued that the failure to achieve significant progress on North-South proposals is a reason for turning to South-South schemes, which have the advantage that they do not require co-operation from the North. But experience with South-South schemes has not been much better.

Hence experience suggests scepticism about the prospects for many of the reforms. Yet, as argued above, the need, today, is particularly great. The experience of the 1970's shows that action does occur when real interests are obviously threatened. In August 1982, governments and international institutions acted together to prevent a collapse of the international banking system, as a result of Mexico's financial difficulties. In the light

of the world's economic situation there is need to combine an element of realistic scepticism with some idealism in analysing and selecting the kind of reforms to promote. In Table 1 some of the considerations advanced here, are brought together for a summary view of the various proposals. As is obvious, a considerable element of subjective judgment is incorporated into Table 1. The 'magnitude' estimate is particularly arbitrary, since it will naturally depend on the size of the scheme when introduced. The estimate is based on an ambitious interpretation of the proposals. But the actual magnitude of the effects of any scheme could of course be small, or even negligible, if only put into effect on a very small basis.

Among the many proposals considered, the largest positive effects on industrialization are likely to come from proposals concerned with world recovery, which have indirect (mainly) rather than direct implications for industrial finance. Substantial positive effects would come from a number of proposals. Some have direct effects on industrial finance, such as loan guarantees and export credit guarantees, and new public institutions designed to channel finance to industry. Others would have mainly indirect effects, like the commodity support schemes and additional SDRs.

Perhaps the 'prospects for implementation' column is most subjective of all. Moreover this may well alter over time. At present, the best prospects are for schemes which will contribute to the support of the international banking system, but do so with a minimal commitment to wholesale reform of the system. Hence there may be fair to good prospects for schemes to insure private loans and for moderate expansion of existing public institutions. Apart from this, prospects for North-South reforms are weak. Prospects for South-South schemes are therefore better, but not strong. A major problem for South-South schemes is that to get full support from the South, they need to offer something to many types of economy. But to do so

could lead to over-ambitious and over-extended schemes.

Many of the schemes are not alternatives exclusively. That is to say they could be put into effect simultaneously, and there may be benefits from doing so. For example, schemes to promote world recovery and thereby contribute towards markets for industrial products from developing countries may fruitfully be combined with schemes to improve the direct provision of industrial finance. Those who call for a new Bretton Woods do so because they see the need for a package of consistent proposals. Within particular categories, there can be conflicts much as those emanating from the necessity to choose between improving the flow of private finance and enlarging public institutions, or creating new ones. Politically, there may be advantages in focusing on a few issues, as the meeting of the Non-Aligned in New Delhi concluded, rather than asking for everything and achieving nothing.

This survey has shown that there is no shortage of ideas in the area of international financial reform. The problem is political. The present set of ideas do not, it seems, respond to the political needs and objectives of the main actors. The intellectual exercise now is to see whether schemes can be devised which do, or whether the political actors are content with the state of the unreformed world.

TABLE 1.

Effects of Various International Financing Reform Proposals on Industrialization in Developing Countries

	Increasing Amounts of Finance		Increasing size of Markets		Potential impact on industrialization	Prospects for implementation
	Direct	Indirect	Direct	Indirect		
Guarantees for private sector						
- for loans	✓	✓	-	-	substantial	Fair to good
- for export credit	✓	-	✓	-	substantial	Good
Enlargement of existing public institutions	✓	✓	-	-	substantial	Good for small enlargement; poor for substantial
New public institutions	✓	✓	-	-	substantial	Fair
Reduce debt 'overhang'	-	✓	-	-	moderate	Fair
Improve commodity finance	-	✓	-	✓	substantial	Fair to good
Extra SDRs	-	✓	-	✓	substantial	Poor
Reform conditionality	-	✓	-	✓	moderate	Poor to fair
Assist low-income countries	✓	✓	✓	✓	moderate	Fair
Schemes to promote South-South co-operation						
- payments union/credit	✓	✓	✓	-	moderate	Fair
- South Bank	✓	✓	-	-	moderate to substantial	Fair
World recovery						
- international co-ordination on expansion	-	-	✓	✓	very large	Poor in short run; better in medium
- reduce exchange rate fluctuations	-	-	-	✓	not significant	Fair
- world central bank	✓	✓	✓	✓	very large	Poor

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Proposals for reform of the international financial system: inplications for industrial financing

	(please check appropriate box) yes	no
(1) Were the data contained in the study useful?	☐	☐
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